The Economist

Is George Bush a socialist?
PAGE 30

California goes bust
PAGE 25

Is Iraq unravelling?
PAGE 39

OTHER PEOPLE'S MONEY
A SURVEY OF ASSET MANAGEMENT AFTER PAGE 46

JULY 5TH-11TH 2003 www.economist.com

Now for Africa

George Bush's new mission

US$4.95 - C$6.95

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition July 5th 2003

Now for Africa
Next week, George Bush will visit Africa. He can do a lot of good, if he chooses ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

America and Africa
Now for Africa

Israel and Palestine
After the ceasefire

Fund managers
The blame game

Hong Kong
A bill too far

Italy and the European Union
Berlusconi performs

Letters

On India and China, the London Stock Exchange, Singapore, Leo Strauss, latitude, rents in New York, degrees

Special Report

West Africa's wars
A region in flames

United States

California in crisis
Is the Golden State governable?

The Supreme Court
We'll make up our own minds

Wesley Clark
General Electric?

The South
My, how you've changed

Latter-Day Saints
Go east, young Mormon

Human rights and terrorism
The pledge

Lexington
Red George

The Americas

Race in Brazil
Out of Eden

Mexico's elections
El Norte gets a voice

Argentina
First blows

Vancouver and the Winter Olympics
Somewhat cool

Asia

Hong Kong and China
For freedom

Kashmir
Summer pleasures

Afghanistan
It's not awful everywhere

Turkmenistan
Time to choose

Indonesia
Getting away with murder

Laos
An angry dinosaur

Middle East & Africa

Post-war Iraq
Walking on eggshells

Israel and the Palestinians

Previous print editions
Jun 28th 2003
Jun 21st 2003
Jun 14th 2003
Jun 7th 2003
May 31st 2003
More print editions and covers »

Subscribe
Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

A survey of asset management

Other people's money
Pension pain
The law of averages
Down to business
Ogling Bogle
Tell us more
For the fortunate few
Cutting their cloth
Acknowledgments
Offer to readers

Business

Luxury goods
When profits go out of fashion

Sporting endorsements
Branded like Beckham

Metrosexuality
Real men get waxed

German restructuring
Second chances?

Russian oligarchs
The boy done good

Digital photography
Mobile snaps

Big Food v Big Americans
Thin end of the wedge

Face value
Trying to be a regular Ghai

Special Report

Private equity
The charms of the discreet deal

Finance & Economics

World trade
Drops on parched soil

GM food and trade
More trouble ahead

American banks
As good as it gets

Wall Street lawsuits
Dismissed

Fund management in Italy
Dependency culture

Economics focus
A saving grace

Science & Technology

Unmanned aerial vehicles
Suspended animation

Clandestine UAVs
A golden eye in the sky

Medicine
Hard as nails

Quarks
Five alive!

Planet hunting
Just like home

One step at a time

Vote-buying in Kuwait
Making cheats accountable

Computer studies in Congo
Light in the Harvard of darkness

Europe

Italy and the European Union
Turbulence for Silvio Berlusconi, at home and abroad

The German and French economies
Co-ordinated kick-start?

French wine
Superleague bouquet

Spain and the Basques
Dangerous stalemate

Portugal's public sector
I'm going to gut it

Charlemagne
Après EU, le déluge?

Britain

The government, the BBC and WMD
What did you do in the war, Alastair?

Tories and Europe
Neither in nor out

Foxhunting
Blooded

Germany and Britain
Bringing back the romance

Employment law
Time's up for ageism

Private schools
Old school ties

House prices
Down they come

Bagehot
The Tories' Catch-22

Articles flagged with this icon are printed only in the British edition of *The Economist*

Books & Arts

Robert Lowell
America's Shelley

Polish Jews
A blessed band

Elizabethan history
Sir Walter Mitty

Mormons who murder
Hells bells

Short stories
Funny girls

The National Theatre
The one hundred days of Mr Right

Obituary

Katharine Hepburn

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Economic forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

D-word index

Emerging-Market Indicators

Overview

Corruption

Economy

Financial markets

Advertisement

Classifieds

Jobs
Governance Fellow on Security and Development (Ref 159)
This is an exciting opportunity to join one of the world's ....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Requests Expressions of Interest for The Development of a New Lignite Mining Facility and Associated New Electric Generating and Transmission

Jobs
Marketing Associate Needed
Marketing Associate Provide analytic support to the Global Product Strategy Group Respo....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Preparation of Competition Bill for Ghana

Jobs
Regional Director Balkans
Job Profile Our Regional Director Balkans (based in Tirana), leads and mobil....

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Jul 3rd 2003
From The Economist print edition

A fragile truce

AFP

After the announcement of a **ceasefire** by Palestinian radicals, Ariel Sharon and Mahmoud Abbas, the Israeli and Palestinian prime ministers, made a public appearance together. Israeli tanks and troops pulled out of parts of the West Bank and Gaza. Several violent incidents marred the truce.

See article: An Israeli-Palestinian truce

It was a violent week in **Iraq**. On July 1st, attackers launched a rocket attack on an American military vehicle in Baghdad. On the same day, an explosion in a mosque in Faluja, west of Baghdad, killed nine Iraqis. The Americans said the blast was caused when an Iraqi bomb-making class went wrong; the townspeople said the Americans had attacked the mosque. George Bush promised to see through America's “massive and long-term undertaking” in Iraq.

See article: Post-war Iraq

Britain, France and the UN urged America to consider sending troops to restore peace in **Liberia**, where rebels threaten to overthrow the president, Charles Taylor. George Bush, mulling whether to respond, called on Mr Taylor to go. Britain hinted that a neutral country should offer sanctuary to Mr Taylor, who faces war-crimes charges in neighbouring Sierra Leone, if that might avert a bloody battle for the capital, Monrovia.

See article: George Bush goes to Africa

Nigeria endured a general strike. Workers were protesting the government's decision to raise the price of petrol from a well-below-market rate to a somewhat less-below-market rate.

Congo unveiled a new transitional government, including most of the country's main rebel groups. President Joseph Kabila urged all sides to “draw a line between the past and the present, and look forward to a bright future.”

Don't mention the war

Italy's prime minister, **Silvio Berlusconi**, making his first appearance before the European Parliament during his country's tenure of the European Union presidency, caused an uproar by likening a German parliamentarian, who had questioned his business and legal entanglements, to a Nazi concentration-camp commander. Chancellor Gerhard Schröder demanded a public apology. Before his outburst, Mr Berlusconi had already been rattled by the abuse heaped on him by newspapers throughout Europe, reflecting a wide perception that he has a shady business background.

See article: Berlusconi's blunder

Germany's cabinet endorsed a package of tax cuts proposed by the country's finance minister, Hans Eichel, designed to boost its stagnant economy, while France's President Jacques Chirac urged tax cuts in his own country to the same end.

See article: The French and German economies

A **Russian** metals-and-oil tycoon, Roman Abramovich, bought London's Chelsea Football Club, in a deal worth around £150m ($250m).

AP

See article: Russia's oligarchs

The Montenegrin government denied a report by an Italian news agency that a magistrate in Naples was investigating allegations against **Montenegro's** prime minister, Milo Djukanovic. He was said to have been involved in organised crime, in particular, smuggling cigarettes.

Court investigation

Argentina's president, Néstor Kirchner, accepted the resignation of Julio Nazareno, the head of the Supreme Court, and nominated a respected criminologist to take his place. The whole court, which had struck down several of the previous president's austerity plans, was facing investigation by Congress.

See article: Nestor Kirchner takes charge in Argentina

Canada was awarded the 2010 Winter Olympics. Vancouver-Whistler must now work out how to pay for the games.

See article: Vancouver gets the Winter Olympics

On the march

EPA

An estimated half a million people took to the streets of **Hong Kong**, protesting over a proposed anti-subversion law that many believe threatens basic rights in the former British colony, and the government's handling of the economy.

See article: China and Hong Kong

Defying some predictions, a speech by Hu Jintao, president of **China**, contained no word of political reform.

About 200 Taliban fighters battled with **Afghanistan** government forces for four days in the Ata Ghar mountains close to the Pakistan border. Three Taliban fighters and six soldiers were reported killed.

See article: Life in Bamiyan

Myanmar's rulers were said to have transferred **Aung San Suu Kyi**, an opposition leader, from the notorious Insein prison to a less awful location. Britain's government asked British American Tobacco to stop doing business in the country.

An express train plunged off a bridge near Hyderabad in southern **India**, killing at least 22 people. India has about 300 train accidents a year.

Australia intercepted a fishing boat with 54 Vietnamese asylum-seekers on board, its first boat-people for around 18 months.

Pol Pot's first wife, Khieu Ponnary, known as “sister number one”, died in Cambodia, aged 83. Pol Pot died in 1998.

The Dean machine

Continuing his increasingly strong challenge for the Democratic nomination, **Howard Dean**, the maverick former governor of Vermont, topped the league for fundraising in the second quarter. He raised $7.5m—half over the internet.

The Supreme Court struck down a Texas law outlawing **gay sex** between consenting adults. The nature of their ruling makes gay marriage more likely.

See article: Surprises from the Supreme Court

Strom Thurmond, America's longest-serving senator and one of its more conservative, died aged 100.

Sean Patrick O'Malley, the bishop of Palm Beach, was chosen to replace Cardinal Bernard Law in Boston, who was forced to resign last year in a scandal over **paedophile priests**.

AFP

California's politicians failed to close a budget shortfall of $38 billion in time for the new fiscal year that began on July 1st. Several other states also missed the deadline and now must suspend salaries for their politicians.

See article: Oh, California

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Jul 3rd 2003
From The Economist print edition

Dismissed

Two American judges ruled in separate cases that four leading investment banks—Merrill Lynch, Goldman Sachs, Morgan Stanley and CSFB—were not to blame for **stockmarket losses** resulting from the bursting of the tech bubble. The banks' analysts had been accused of issuing biased research. One judge suggested that investors were “obsessed with the fantasy of Olympian riches”, which possibly clouded their judgment.

See article: Wins for investment banks

Cazenove said that annual pre-tax profit had tumbled by 77% to £14m ($22m). But the blue-blooded British stockbroker, which ministers to the needs of many of the country's biggest companies, still plans a stockmarket listing, despite previously abandoning a flotation in January.

Playing the field

Hamley's withdrew its support for a £52.2m ($86.9m) bid from Baugur, the group behind Iceland, a leading frozen-food retailer. Britain's most famous toyshop received a counterbid of £53.1m from Tim Waterstone, an entrepreneur behind an eponymous bookshop chain. Baugur then upped its offer to £58.7m.

Debenhams, a British department-store group, said that another suitor had emerged to rival Permira, an investment firm that is mulling an offer of around £1.5 billion ($2.5 billion). The new potential bidder is thought to represent two investment groups, CVC Capital Partners and Texas Pacific, along with John Lovering, a retail entrepreneur.

Yell took advantage of the improved state of the stockmarkets to revive a flotation abandoned last year. The sale could raise around £950m ($1.5 billion) for Britain's largest phone-directory business, valuing the company at around £2 billion.

WPP's shareholders were not distracted at the firm's annual meeting by Sir Martin Sorrell's high-profile bid to acquire Cordiant, a rival advertiser. WPP's chief executive suffered the ignominy of a refusal by nearly half his shareholders to support his three-year contract.

Financial engineering

Alstom admitted accounting “improprieties” at an American subsidiary, which will force it to take a charge of *euro*51m ($59m). The FBI and the Securities and Exchange Commission began probes of the French engineering giant's American unit. Even so, Alstom's shareholders approved a *euro*600m rights issue to shore up its finances.

Ahold, a Dutch retailer once dubbed Europe's Enron, revealed the extent of the accounting irregularities that earned it the title. A probe uncovered a *euro*970m ($1.1 billion) hole in its accounts, including $856m at its American Foodservice unit, which is now under legal investigation.

As **Vivendi Universal** studied five competing offers for its American entertainment assets, Jean-Marie Messier, the man who ran up the debts to acquire them, won his case for severance pay at an American tribunal. Vivendi vowed to fight the *euro*20m ($23m) award to the architect of its woes.

Net profits at **Gucci** tumbled by 97% in the latest quarter compared with a year ago. The luxury-goods group made just *euro*1.2m ($1.4m), and ran up an operating loss. It blamed SARS and the war in Iraq for the reluctance to buy fancy products: “Everything that could have gone wrong did go wrong”, the firm conceded.

See article: Trouble in luxury goods

The European Parliament passed laws requiring the labelling of **genetically modified foods**, which should bring an end to Europe's moratorium on GM products. But America is unlikely to drop its challenge to the ban at the World Trade Organisation; and labelling will deter consumers from buying America's imports.

See article: New EU rules will rile America

Slim chance

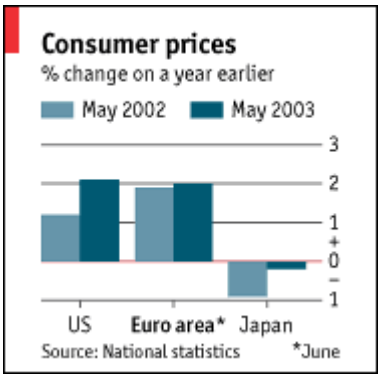
Kraft Foods is to put its customers on a diet. The food giant attempted to avert public disquiet over growing obesity, and lawsuits from the porky, by announcing that it would cut the size of snacks and may reduce their fat and sugar content too. More cheaply produced products should fatten profits while slimming Americans (maybe).

See article: Thin end of the wedge

Wal-Mart dented its conservative image by revealing that it would extend its corporate anti-discrimination policy to include gay employees. But the world's biggest retailer will doubtless continue to sell guns, while barring the sale of mildly titillating magazines or CDs with what it deems offensive lyrics.

Problems loom

Inflation in the **euro area** inched up to 2% for the year to June; and the European Commission said growth was unlikely to meet modest forecasts made three months ago as the strong euro hits exports. Persistent low growth could force Germany to breach the stability pact's budget-deficit ceiling again in 2004, calling into question the efficacy of the rules.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

America and Africa

Now for Africa

Jul 3rd 2003
From The Economist print edition

Next week, George Bush will visit Africa. He can do a lot of good, if he chooses

GEORGE BUSH'S first visit to Africa was a frivolous affair. His father sent him to tiny Gambia in 1990 for a jolly party marking 25 years of independence. He was treated to fireworks, spinning dancers and a riverboat procession. No one expected him to do much, except smile and make small talk. Next week, when he returns to the continent for a five-day tour, every African government will be hollering for his attention, as will hundreds of charities, pressure groups and companies with interests in Africa. There have also been crowds outside the American embassy in Liberia, at least during lulls in the fighting, pleading for him to send troops to rescue them. As *The Economist* went to press, a reluctant Mr Bush seemed about to accede to those pleas.

Africa has, to put it mildly, a lot of problems; even a hyperpower cannot solve them all. Mr Bush has his hands full trying to rebuild Iraq, brokering peace talks in the Middle East, and facing down North Korea. Meanwhile, his deep budget deficit leaves little cash to spare for sorting out strategically unimportant parts of the world. So it is surprising that Mr Bush is showing such interest in Africa. His tour will include five countries: the continent's two main powers (South Africa and Nigeria), and three small but successful countries (Senegal, Botswana and Uganda). Talks will focus on security, trade and aid.

For Mr Bush, security means, first and foremost, preventing terrorist attacks on Americans in Africa. Al-Qaeda has little support south of the Sahara, but finds it easy to operate in countries with lax security—hence its successes blowing up embassies in Kenya and Tanzania in 1998, its more recent murders of Israelis in Kenya and the suicide bombings by an unknown Islamist group in Morocco in May. This week, Mr Bush promised $100m to east African countries to beef up the security around their airports, sea ports and other vulnerable places, which should help a bit.

When terrorists murder westerners in Africa, a much larger number of Africans usually die, too. But African leaders do not get nearly as worked up about terrorism as Americans do, because they have much bigger security problems to contend with. Africa's wars claim thousands of times more lives than al-Qaeda. Nigeria and South Africa each do their bit to try to keep the peace in their respective spheres of influence, but both would like some American help.

The fire in West Africa

Africa needs American help most immediately in Liberia. The civil war in this small west African state is not only a tragedy in itself but is also fuelling other wars in the region (see article). America has been

reluctant to commit troops to Africa since the debacle in Somalia a decade ago, when 18 of its soldiers were killed. More recent precedents, however, are more encouraging. The British army stopped a terrible war in Sierra Leone in 2000. Last year, French troops prevented Côte d'Ivoire from falling apart. In both cases, superior arms and training quickly over-awed ill-disciplined opponents. But the faltering peace in both Sierra Leone and Côte d'Ivoire is now threatened by the chaos in Liberia, which borders both countries. This is why France, Britain and the UN are urging America to help pacify its former colony, as they have theirs.

America may be stretched by its military commitments in other parts of the world, but an intervention in Liberia need not require too many American soldiers. The gunmen wrecking the country are a rabble, who would flee if faced by even a small American force. Besides, so long as America gave the lead and handled the high-tech logistics, Nigeria and others would be prepared to supply extra manpower. And there is no doubt that more or less any intervention force would be welcomed by the locals, who are praying for one.

Most of Africa is not at war, however, and needs different kinds of help. As a baby-eating right-winger, Mr Bush is loved neither by Africa's chattering classes nor by the West's professional worriers about Africa. But he has a habit of surprising foe and friend alike. His recent promise to give $15 billion to the fight against AIDS prompted Bob Geldof, a campaigning Irish rock star, to tell Britain's *Guardian* newspaper that “You'll think I'm off my trolley when I say this, but the Bush administration is the most radical—in a positive sense—in its approach to Africa since Kennedy.”

Say that again?

Startling words, and up to a point Mr Geldof is right. Encouragingly, Mr Bush has said he wants to reverse the trend since the end of the cold war for rich countries to cut their aid budgets. His promised AIDS billions are a welcome start, though some of the money is tied to unrealistic plans that focus solely on sexual abstinence and neglect condoms. Last week, he re-pledged a 50% increase in America's core development assistance over the next three years. Sensibly, he says he wants to direct American aid dollars towards well ruled countries with liberal economies, to help them spend more on health and education. The promise of such aid gives an incentive to badly run countries to reform. If, for instance, Robert Mugabe were to resign, Zimbabwe would be showered with American cash.

All this is good. Yet America remains one of the world's stingiest donors. It gives away barely 0.1% of its GDP each year, of which little goes to Africa. Almost every other rich country gives at least 0.2%. Denmark, the most generous, gave 0.9% last year. Aid from European countries (especially from Scandinavian ones, and from Britain) also tends to have fewer strings attached. Too much of America's charity is conditional on the recipient's buying American goods and services, which are often too costly or inappropriate. The United States may be the world's largest donor of food, but its donations are often designed as a backhanded subsidy for American farmers. Instead of dumping American cereal surpluses on hungry countries, America should buy local grain and distribute that, thus stimulating agriculture where it is most needed.

As African leaders often point out, however, trade is more important than aid. Here, Mr Bush's record is slightly better than Europe's, though still poor. On the plus side, both America and Europe have struck piecemeal trade deals with various African countries. Mr Bush, for example, has asked Congress to extend a deal which lets 38 of them export goods duty-free to America, but which expires in 2008. Europe, for its part, allows the world's poorest countries to export many goods tariff-free, but excludes certain “sensitive” agricultural products. These sensitive products tend to be those that African farmers can grow cheaply but European farmers can't.

What Africa really needs is sharp cuts in rich countries' farm subsidies. These are higher in Europe than in America, despite last month's lukewarm reform of the EU's Common Agricultural Policy and Mr Bush's disgraceful handouts to American farmers. The average European cow attracts more subsidy than the average African farmer earns, which obviously makes it difficult for beef farmers in Botswana to compete with beef farmers in Europe. Farm subsidies are also the main obstacle to progress in the Doha round of world trade negotiations, whose success is vital to help poor countries trade their way out of poverty. Mr Bush can expect a polite ear-bashing about this next week. He should listen.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Israel and Palestine

After the ceasefire

Jul 3rd 2003
From The Economist print edition

Next, with luck, will come two (non-violent) civil wars

Get article background

EPA

AFTER all the darkness, the flicker of hope from Israel and Palestine this week looks from afar almost like a beam. The people on the spot are harder to dazzle. Yes, Hamas and the other Palestinian extremists have declared a temporary ceasefire, which is better than no ceasefire at all. And, yes, Israel has withdrawn its forces from parts of Gaza and Bethlehem, which is better than no withdrawal at all. But relations between Arab and Jew in Palestine are still far, far worse today than they were three years ago, before the collapse of the Camp David summit, the eruption of the *intifada* and Israel's reconquest of the areas it had ceded to the Palestinians during the 1990s. Though Ariel Sharon and Mahmoud Abbas, the Israeli and Palestinian prime ministers, shook hands warmly for the cameras (and for George Bush) on July 1st, a poll showed that less than half of the people on each side thought a political settlement would ensue. Worse, only 18% of Palestinians and a mere 6% of Israelis expected all violence to cease.

Their pessimism is justified. The zealots of Hamas and Islamic Jihad say that they will not accept the permanence of the Jewish state even in its 1967 borders. They almost certainly intend to resume their attacks once they have drawn breath, and once they have been seen by Palestinians at large to have given Mr Abbas a reasonable chance (which they are sure will come to naught) to get the Israelis out peacefully. In the meantime, says Mr Abbas, his shattered Palestinian Authority (PA) cannot disarm these groups forcibly, as the international “road map” requires. But Israel's security people say that unless he does, Israel will not transfer any more bits of occupied territory to him. In the end, the Israelis argue, Mr Abbas—and any responsible Palestinian leader—must choose between peace with Israel or peace with Hamas. So long as Hamas is intent on Israel's destruction, it is impossible to have both.

On the face of it, the Israelis are right. How can they be expected to put their trust in a two-state solution if the putative Palestine contains a private army that is not under the Palestinian government's control and whose declared aim is to destroy its neighbour? On the other hand, Mr Abbas is also right to fear the consequences of picking an armed fight with the rejectionists. Although (and to some degree because) he has been embraced by Israel and America as a more credible interlocutor than Yasser Arafat, his personal following among Palestinians is negligible. So although, on paper, the PA still has many armed men under its control, it is far from clear whether they would obey an order from Mr Abbas to open fire on fellow Palestinians—especially those in Hamas and Islamic Jihad, whose apocalyptic aims may not be widely shared but who are nonetheless admired for having been in the forefront of the fight against Israel during the bitter years of *intifada*.

How to defeat the demons within

Is there an escape from this impasse? The best hope is that Mr Abbas will indeed defeat Hamas—but not primarily by violent means. This is not as far-fetched as it sounds. Although Hamas's ceasefire is for three months only, its leaders will need to think carefully about what a decision to resume the struggle will mean for their own popularity. If the ceasefire and the road map have improved the lot of the Palestinians and inspired real hope of independence to come, it could be difficult for Hamas to justify

renewing its campaign of violence and so inviting a return to all the suffering of the *intifada*. In principle, this gives Israel itself an interest in helping Mr Abbas make rapid and visible gains. These will have to include not just the lifting of curfews and closures, the creation of jobs and the removal of Israeli forces from Palestinian towns and villages. Israel will also have to show a sceptical Palestinian population that it, too, is genuinely committed to a two-state solution.

Here, Israel faces a civil war of its own. Again, this will entail a convulsion, though not necessarily a violent one. Just as any responsible Palestinian leader must take on and defeat the ideas that Hamas stands for, so any responsible Israeli leader must defeat the idea that the Jewish settlers in the territories stand for—that, for reasons of religion and ideology, a Jewish minority is entitled to rule these Palestinian areas forever.

This battle was hard enough for Labour prime ministers such as Yitzhak Rabin and Ehud Barak to contemplate. It will be harder still for Mr Sharon, who built his political career in part on becoming the settlers' champion. Forcing Mr Sharon to embark on this internal Israeli fight will require a clever combination of goading from America and sweet reasonableness, aimed over Mr Sharon's head at Israeli opinion, from Mr Abbas. But if a solution is to come, these civil wars in Israel and Palestine must come first. Only on the day when the moderates on each side make common cause against their own extremists will onlookers know that peace is drawing near.

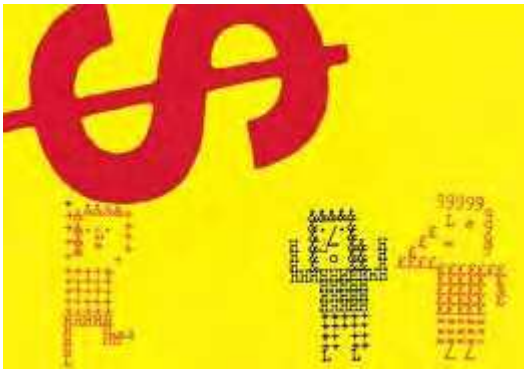
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Fund managers

The blame game

Jul 3rd 2003
From The Economist print edition

A little-noticed guilty party in the stockmarket's boom and bust



AFTER the bubble, the blame. Over the past two years, investors, regulators and prosecutors have competed to hurl mud and lawsuits at anybody they could plausibly hold responsible for causing such big losses to so many. Bosses have been blamed for cooking the books and inflating their pay; auditors faulted for being too cosy with their charges and even helping in the cooking; investment bankers singled out for dodgy research and touting dubious stocks. But one set of actors in the tragedy has so far escaped largely unscathed: the fund managers who look after investors' money.

As our survey in this issue argues, however, fund managers were far from blameless. Indeed, they were right at the heart of the bubble. Throughout the 1990s, they were urging investors to pile into equities, often of the riskiest variety. They reaped enormous profits from their clients' gullibility, since their pay depended largely on the market value of the assets they had under management. Their fees and charges were typically buried in the small print. And they were just as guilty as Wall Street banks of misleading investors: tales of heroic past performance and of safe double-digit returns reinforced the foolish notion that markets would rise forever.

The truth is that, for the most part, fund managers have offered extremely poor value for money. Their records of outperformance are almost always followed by stretches of underperformance. Over long periods of time, hardly any fund managers have beaten the market averages. They encourage investors, rather than spread their risks wisely or seek the best match for their future liabilities, to put their money into the most modish assets going, often just when they become overvalued—whether tech stocks and dotcoms in the late 1990s or, now, corporate bonds, hedge funds and private-equity funds (see article). And all the while they charge their clients big fees for the privilege of losing their money.

Even so, lawsuits against fund managers are unlikely to fly. Two New York judges have just dismissed suits against various investment banks over equity research (see article): proving wrongdoing by a fund manager will be harder still. The regulation of fund managers should be tightened up: notably, by standardising tables of past performance and insisting they be accompanied by health warnings in large print, and by requiring fund managers to disclose all fees and charges, including transaction costs, upfront. But broadly, investors should accept more blame themselves for their losses: they were starry-eyed about likely returns and ignored signs of overvaluation.

There are, however, two more specific lessons that investors should learn from their experience with fund managers. One is the merits of indexed investing. Whether you are a retail investor in a mutual fund, or a pension-fund trustee, you will almost never find a fund manager who can repeatedly beat the market. It is better to invest in an indexed fund that promises a market return but with significantly lower fees.

The second lesson is the need to balance risks and returns more carefully. A pension fund, with predictable long-term liabilities, should not normally be invested only in high-risk equities, for example. A retired couple in search of a steady income should not put their nest egg into a fund that invests only in volatile tech stocks or high-risk emerging markets. In the long run, high returns are available only in exchange for taking high risks. Investors should remember that truth, and allocate their savings accordingly.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hong Kong

A bill too far

Jul 3rd 2003
From The Economist print edition

The new internal-security bill needs amending, and preferably scrapping

Get article background

AFP

IT IS now all but certain that within the next few days Hong Kong will have a new internal-security law which, were it a democracy, could never be passed. Fortunately for the government in Beijing and its hand-picked chief executive in Hong Kong, the bumbling and deeply unpopular Tung Chee-hwa, it is not a democracy. Only 24 of the 60 seats in Hong Kong's Legislative Council are directly elected.

The bill is not wholly bad, and it is to the government's credit that it has paid some attention since its original outline proposals were published for comment last year. In some respects it even marks an improvement on the existing colonial laws: the crimes of treason and sedition, for instance, are now properly defined, in terms of the commission of violence. On the other hand, whole new crimes, principally those of “subversion” and “secession”, the former already used with gay abandon against dissidents in China, have been introduced.

There are plenty of other complaints. One section of the bill provides a mechanism to ban any organisation in Hong Kong that is deemed to be subordinate to one banned in China on security grounds—which could easily be used against the religious group Falun Gong, or perhaps against the Hong Kong Alliance, which organised protests in China after the Tiananmen Square massacre. Also included is a clause that would make it an offence for newspapers to publish material gleaned from secret state documents, without any countervailing public-interest defence. Though abuse of any of these innovations seems unlikely in the current climate, they would be most useful to a compliant leader in Hong Kong in the event of a future political upheaval in China.

All these defects, coupled no doubt with a general sense of dissatisfaction, drew close to 500,000 people on to the streets of Hong Kong to protest on July 1st (see article). It was by far the largest demonstration seen there since 1989, when the Tiananmen massacre brought out a million, forever shattering the myth that Hong Kong cares only about business. Hong Kong's Democrats have tabled amendments to correct these abuses. They will be debated next week. But given Legco's composition, they have virtually no chance of success.

The bill, however, is not just bad in some of its particulars: it is bad in principle, too. Even if the amendments the Democrats would like to see were miraculously passed, its timing is hopeless. Hong Kong's economy has suffered a treble blow in recent years, from the Asian financial crisis, the post-September 11th slowdown and, more lately, SARS. It is a fragile creature that could do without self-inflicted wounds of this kind.

The great mystery in all this is just why China ever embarked on such a course. Apart from anything else, it is having a powerful effect on Taiwan's interest in any form of reunification with the mainland. Hong Kong and the mainland have lived together on the whole pretty happily over the past six years: for the most part, Hong Kong's Democrats have kept their politics local. It is true that the security bill is a requirement laid on the Hong Kong government by Article 23 of the Basic Law, Hong Kong's constitution. But until last year, the whole matter had been quietly neglected.

If the bill does go through unaltered, one casualty is sure to be Hu Jintao's reputation in the West. On

June 19th, President Bush's spokesman explicitly called for the bill to be modified, and implicitly threatened that, if it is not, there may be economic consequences. Mr Hu, who has been China's president for the past four months, though leader of its Communist Party for eight, has sometimes been viewed as a potential if cautious reformer. Encouragingly, he has been more open than would have been possible in the past about a recent submarine accident, and he dismissed a minister and a mayor over China's flat-footed and secretive response to SARS. But by allowing the tame government in Hong Kong to press ahead with the security bill, and by failing in his eagerly awaited speech of July 1st to support even the most limited of political reforms, he has now disappointed the world twice.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Italy and the European Union

Berlusconi performs

Jul 3rd 2003
From The Economist print edition

Italy's prime minister is a bad joke, abroad as well as at home

AFP

Get article background

AT LEAST you cannot accuse Silvio Berlusconi of making life dull, either in Italy or, it now seems, abroad. This week, after stepping up to the rostrum for the first time to speak for Europe as prime minister of the country that will hold the EU's presidency for the next six months, he surpassed even his own standards of crass buffoonery: he likened a German MEP, who had the temerity to question Mr Berlusconi's legal entanglements, to a Nazi concentration-camp commander. That rivals his declaration a couple of years ago that Islam was responsible for producing an inferior civilisation. (These days, by the way, he says he wants to host, in Sicily, a conference to make peace in the Middle East.)

Even before his latest outburst, Italians of all stripes had been embarrassed by the hail of sneering and abuse, mainly on account of his perceived lack of probity in public life, that had greeted his uptake of the EU presidency (see article). Earlier this week, thanks to an immunity law rushed through Italy's parliament with indecent haste, a court had suspended a trial in which Mr Berlusconi faced charges of having bribed a judge. So at least he is saved from the chance of an even greater embarrassment—had he been found guilty of that crime while standing on the global stage as the honorific personification of Europe. It is all terribly shoddy. Laughable, too. But does it actually matter?

The answer is that it does a bit—although in six months people may well look back on this week's particular episode with a shake of the head and a chuckle at the sheer nerve of the fellow. Still, the wider Berlusconi affair and the fact that so flawed a man has managed to rise to such prominence in both Italy and Europe does raise bigger issues. For one thing, the country holding the EU presidency can make a difference, albeit often in a negative way, just by making a hash of the agenda. Mr Berlusconi has a wodge of EU-wide ideas, some of them perfectly well-intentioned—for instance, to boost Europe's economies, to address the public-pensions crisis, to tackle illegal immigration, and to repair Europe's relations with America, with which he has a cosy rapport. Most important of all, he seeks agreement from all 25 of the EU's present and future countries on a European constitution. Diplomacy of the kind evinced by the EU's president in the European Parliament this week is hardly likely to further such aims.

But there is a still deeper problem. It is that the European Union cannot work well without a strong presumption of mutual trust within the club. For one thing, as integration tightens, it is crucial that all countries respect each other's judicial systems. In Italy, the case of Mr Berlusconi makes it extraordinarily hard to sustain such respect. Even though he has never—thanks to reversals on appeal and statutes of limitation—been definitively convicted of the many crimes of which he has been accused, he has thrice been found guilty in the first instance, while he and some of his closest business and political associates (often one and the same thing) have been facing a string of further serious accusations, which recently brought one of them an 11-year sentence in prison.

Mr Berlusconi claims that his country's judiciary is bent, because its judges are politically biased—against him, of course. That is one possibility. Another is that Italy—and now, to a degree, Europe—is led by a man of very questionable integrity. Either way, it is a shocking state of affairs, and one that mocks Europe's claim to be a model of democratic values.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Jul 3rd 2003
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Clash of the titans

SIR – One factor that has made India look less successful than China is transparency ("Two systems, one grand rivalry", June 21st). India's problems are open to the world and, more importantly, to Indians themselves, thanks to a democratic system and a free press. The Chinese regime can manipulate information shamelessly or, even worse, cover it up—witness the recent public-health crisis created by SARS. Not even China's own leaders understand fully the extent of the country's social, political and economic problems, nor when or how these might explode in their faces.

Lin Chih Tu
Tainan, Taiwan

SIR – Agricultural reforms in 1978 originally caused China's take-off. The reforms increased farm incomes and created a market for basic manufactured goods. From this beginning the manufacturing sector acquired its own momentum to get where it is today. Domestic demand set the process in motion, not exports. For India to repeat this trick what it needs above all is land reform that would raise the economic security and purchasing power of the hundreds of millions who toil on the land. If India was a true democracy it would get reform tomorrow because a clear majority would benefit. Instead, reform is frustrated by the manipulation of the system by narrow interests who prefer the status quo.

Paul Dixon
Richmond, Surrey

A market for clearing

SIR – The London Stock Exchange's position on the consolidation of Europe's clearing infrastructure is founded on the interests of the market ("Entente peu cordiale", June 28th). Far from making "a virtue" of necessity, our position is based on the clear vision of an independent, pan-European central counterparty to facilitate real competition between exchanges' trading services. That vision is not in doubt, and the language used by the London Clearing House and Euronext in their merger announcement confirms its validity. The LSE's concerns with the proposed creation of LCH.Clearnet centre on just how it is meant to live up to its promise.

We have been trying for some months to understand how the combination will work, but all we have heard from LCH boils down to "trust me". This is not a business proposition. As it stands, with LCH intent on becoming a "for profit" monopoly in which one of our major competitors is also its major shareholder, there is nothing to prevent users becoming losers. In requesting a new clearing-services agreement from LCH, we are asking no more than we would of any other commercial supplier of important services. It is a great pity that they could not have worked through this with us, and other London exchanges, before announcing their engagement. So, while LCH may well have been "disappointed" by our public response to the news, they should hardly have been surprised.

Clara Furse
Chief executive
London Stock Exchange
London

Regulation in Singapore

SIR – In your article on regulating capitalism in South-East Asia you refer to a “dilemma over the lingering legal fallout” from the Asian crash of 1997 purportedly faced by Singapore in its treatment of defaulters such as Asia Pulp and Paper (APP) (“Unreformed, unrefined, unrepentant”, June 21st). Singapore faces no such dilemma. Our laws have always been robustly, consistently and impartially enforced. Singapore consistently ranks highly in international and regional rankings of corporate governance, transparency and the administration of justice. These include rankings by reputable bodies such as Transparency International and Standard & Poor's.

APP was listed not on the Singapore exchange but on the New York Stock Exchange. However, as APP is incorporated in Singapore, the Commercial Affairs Department (CAD) conducted detailed investigations into whether any Singapore laws were breached. Due to the complexities of the case, these investigations have only recently been completed. The CAD is currently pursuing the matter further.

Shane Tregillis
Market Conduct Group
Monetary Authority of Singapore
Singapore

Virtue's reality

SIR – You are right that the rise of Straussians in the upper echelon of the Bush administration suggests that American conservatism has shifted its focus from liberty to virtue (Lexington, June 21st). This shift is indeed a far more important aspect of Leo Strauss's influence than the occasional resort to Platonic “noble lies”. The shift is both fundamental and pernicious.

Friedrich Hayek and Karl Popper based their appeals to liberty on the primacy of rational thought and the free competition of ideas. The “virtue” of Plato and Strauss is based on appeals to God or history and is not subject to rational challenge. There is no difference between the appeal to virtue of religious fanatics in parts of the Islamic world and that of their opposite numbers in and around the Bush administration.

Walter Zwick
London

Not far north

SIR – While there is no question that Fort McMurray may be a tad on the chilly side on a cold day in January, it is hardly an Arctic community (“There's oil in them thar sands!”, June 28th). At a latitude of 56° 39', it is well south of the Arctic Circle (66° 32'), and even south of Aberdeen (57° 09') or Stockholm (59° 20').

Charles Schell
Latitude 53° 53'
Prince George, Canada

Rent asunder

SIR – I live in a rent-stabilised apartment and currently pay about half the market rent in my newly trendy Lower East Side neighbourhood (“The great Manhattan rip-off”, June 7th). While the theoretical underpinnings of your argument about rent control may be correct, I am a hospital worker who could not afford to live within an hour of my place of employment were I not protected from the surge in rents over the past years.

Even if rent controls were phased out and the equilibrium free-market price was to fall by 20-25% from current levels the whole of Manhattan would be off limits to all but the exceedingly well off and the very poor. My city would thus lose many of its middle-income residents and become something of a museum town, where those who give the city its life and lustre are relegated to the outer nether-regions—rather like, dare I say, London.

Mike Barr
New York

A little learning

SIR – So arts graduates from British universities command less in the jobs market than those without any degree at all ("Money back", June 21st). Is this yet another case of a nationalised industry producing things that nobody wants to buy?

Eamonn Butler
Director
Adam Smith Institute
London

American banks

SIR – I enjoyed Buttonwood's article on American banks "Getting better, or just lucky", Economist.com, July 1st). However, I cannot agree with his three possible explanations for bank stocks outperforming the rest of the market (the world has changed; banks have changed; or banks have got lucky). Other possibilities include 1) someone is manipulating the market of bank stocks and 2) the banking business is more protected than other businesses and this has a positive impact on bank shares.

Alex Wolf
Montreal

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

West Africa's wars

A region in flames

Jul 3rd 2003 | ABIDJAN, FREETOWN AND MONROVIA
From The Economist print edition

AP

West Africa's civil wars are spilling across borders. Can they be contained?

BEREAVED Liberians dumped 18 sticky corpses outside America's cliff-top embassy in Monrovia last week. Then, struggling to make themselves heard above the roar of machine-guns, they yelled out a simple, heart-felt message: “George Bush, save Liberia!” Then they scattered, as grenades tore up the road.

Rebels have attacked Liberia's capital twice in the past month, leaving an estimated 1,000 civilians dead. Tens of thousands more—mostly refugees from around the region—are cowering in the city's rotting football stadiums, its churches and its cavernous Masonic lodge. Most western aid-workers have flown, leaving local fugitives subsisting on roots, grubs and puddle water. Cholera is raging.

Unsurprisingly, Mr Bush, who is making a tour of Africa next week, will not be touching down in Liberia. Instead, he will be visiting the continent's two most powerful countries (South Africa and Nigeria) and three of its better governed ones (Senegal, Uganda and Botswana). However, as *The Economist* went to press, there were signs that a reluctant Mr Bush would decide to send some American troops to Liberia. His reluctance is understandable. America has more to gain by engaging with sensible leaders than with the likes of Charles Taylor, Liberia's besieged despot. It is also easier to help countries that are trying to help themselves. But Mr Bush would be right to intervene. Chaos in one country tends to infect the neighbours.

West Africa's civil wars are usually reported as tragedies befalling individual states. This month, the spotlight is on Liberia. A couple of months ago, the conflict in Côte d'Ivoire received more attention. Before that, it was Guinea, and before that, Sierra Leone. In fact, all these wars are intertwined, and it is impossible to understand one without reference to the others.

If one thinks of Liberia as an isolated calamity, the case for American military intervention is weak. Granted, America has old links to the country—it was founded in 1847 by freed American slaves—but Liberia has no strategic or economic significance. Its people are suffering, but a cynic might point out that there are only 3m of them. If, however, one sees Liberia as a flaming match in a petrol-drenched neighbourhood, the case for extinguishing that flame is much stronger.

It is a complicated story. Liberia's instability threatens Sierra Leone, which is struggling to recover from a

devastating war for which Mr Taylor is largely to blame. Mr Taylor has also backed rebels in Guinea. Guinea's president, Lansana Conté, beat them back, but his country remains fragile. Mr Conté is thought to be terminally ill, yet he refuses to name a successor, so most Guineans expect a coup—or worse—when he dies. Most important, Liberians have fought on both sides of a new war in Côte d'Ivoire, the most sophisticated economy in West Africa and the second-largest, after Nigeria. If Côte d'Ivoire were to go the way of Liberia, it would cripple the three landlocked states—Burkina Faso, Mali and Niger—that depend on remittances from migrant workers in Côte d'Ivoire.

Taken as a whole, West Africa's crisis is one of the world's worst. The regional war has claimed perhaps half a million lives, and continues to blight millions more. This is why it is not only hysterical crowds outside the American embassy who are begging Mr Bush to send troops. France, Britain and the UN are demanding the same.

Taken as a whole, West Africa's crisis is one of the world's worst

A Taylor-made catastrophe

Surprisingly, given Mr Bush's recent call for him to resign, so is Mr Taylor. Addressing some of the few journalists in Monrovia whom his security services have not threatened to kill, he said: “I think the US ought to come now, to use my strength, my popularity and my legitimacy, and work to bring peace in Liberia.”

Mr Taylor was perhaps not being entirely genuine. He has promised before to stand down, most recently as part of a ceasefire agreement last month. He then issued a clarification, however: he had only said he was “prepared” to stand down, but since the Liberian people were clamouring for him to remain, he would have to. Mr Taylor is understandably reluctant to leave office. The international court in Sierra Leone has issued a warrant for his arrest on war-crimes charges.

Things look tough for him at home, too. A group called Liberians United for Reconciliation and Democracy (LURD) and a sister-force, the Movement for Democracy in Liberia (MODEL), control most of the country and are poised to take the capital. Mr Taylor's foot-soldiers, boys in women's wigs or shaven-headed girls in shower caps, are vigorously looting. One Monrovia resident describes how they attempted to shoot and eat her neighbour's dog. But it was nimble and they were drunk, so they killed her neighbour by mistake.

Mr Taylor first rose to prominence in 1989, when he marched into eastern Liberia with a band of Libyan-trained guerrillas. Though American-educated, he charmed the local tribesmen. With their help, he marched on Monrovia, and was prevented from capturing it only by a Nigerian intervention force backed by Sierra Leone, Liberia's northern neighbour. Foiled and furious, he predicted that Sierra Leone would soon “taste the bitterness of war”.

It did. In 1991, Mr Taylor sent 100 men to capture Sierra Leone's diamond fields, commanded by a Sierra Leonean, Foday Sankoh. Mr Sankoh rounded up reluctant locals, especially children, to join the

rebel army he called the Revolutionary United Front (RUF). With Mr Taylor's support, the RUF depopulated half the country, murdered an estimated 200,000 people, and hacked the limbs off thousands more. Both Mr Sankoh and Mr Taylor are alleged to have profited from the illicit trade in Sierra Leone's diamonds.

The UN sent peacekeepers in 2000, but the RUF took them hostage, skinning several alive. Finally, Britain intervened. While British paratroopers secured the capital, Freetown, special forces quietly routed the RUF's drug-addled killers. Peace was restored.

Back in Liberia, in 1997, Mr Taylor had terrorised voters into electing him president, but he was not satisfied. As his power in Sierra Leone waned, he sent a force of ex-RUF fighters, Liberian troops and a few Guinean dissidents to invade Guinea. (His excuse was that Liberian rebels were using Guinea as a base.) Mr Taylor's men swiftly seized a third of the country, pausing only to shoot up refugee camps. But with American military aid, and the Liberian rebels' help, Guinea pushed them back.

With that, the tide began turning against Mr Taylor. In Sierra Leone, the UN persuaded 25,000 half-starved RUF rebels to give up their guns. Meanwhile, Guinea armed and trained the anti-Taylor Liberian rebels, who rechristened themselves the LURD. With Sierra Leonean militiamen swelling its ranks, the LURD pushed deep into northern Liberia.

AFP

Charles Taylor, waving goodbye?

Panicked, Mr Taylor launched a terror campaign, popularly known as “Operation No Living Thing”, to deter the locals from offering support. It backfired. “He killed my uncles, my sisters, my brothers, half the people in my town are dead 'cos he burned that place to shit,” says Major Forma Kanneh, a LURD fighter recovering from wounds in Freetown. He adds, in eloquent pidgin, Liberia's *lingua franca*: “After that, me and a lot of innocents take arms.” The arms were supplied by Guinea, says Mr Kanneh, but the uniform—a pair of blue flip-flops—he bought himself.

A looter's paradise

Late last year, the neighbourhood's troubles spilled into Côte d'Ivoire, long the most stable country in West Africa. There is a lot to destroy there. Visitors to Abidjan, the commercial capital, are immediately impressed by its smooth roads, glossy skyscrapers, French restaurants and vast seaport. All this is now at risk.

An army mutiny in September snowballed into civil war, pitting rebels from the north, reportedly backed by Burkina Faso, against a government dominated by southerners. Northerners have several justified grievances. The current president, Laurent Gbagbo, has tried to redefine Ivorian citizenship to exclude virtually everyone outside his own tribe. In a country that has traditionally welcomed immigrants, who now make up roughly 25% of the population, this is incendiary. He has made it hard for northerners to get identity cards (and therefore to vote), and he has allowed his supporters to drive “immigrant” farmers off their land and grab it. This has affected a lot of Burkinabés—hence Burkina Faso's alleged support for the rebels.

The rebels marched towards Abidjan, but were blocked by the French army, which now enforces an uneasy stalemate. Under French pressure, the two sides signed a ceasefire in January and formed a government of national unity. But the country remains split in two, with the rebels controlling the north, the government controlling the south, and French and West African peacekeepers keeping the two sides apart. The north and south are more or less calm, but in the west, near the Liberian border, the war sizzles on.

The western town of Bangolo has been comprehensively pillaged twice in the past six months, first by rebels and then by militiamen fighting for the Ivorian government. The marauders ransacked homes, ripped petrol pumps from their concrete bases and stripped the town's hospital of drugs, mattresses, air-conditioners, light fixtures and anything else worth stealing. All they left behind were crushed beer cans and empty cigarette packets with labels reading “Sold in Guinea”.

It is a small reminder of how porous West Africa's borders are. Contraband

smokes move effortlessly from country to country, and so, unfortunately, do men with guns. Not long after Côte d'Ivoire's war began, Liberian militiamen—probably with Charles Taylor's backing, for he hates Mr Gbagbo—paddled across the river that separates the two countries, and started killing and looting. Mr Gbagbo's army, in keeping with an old Ivorian tradition of getting foreigners to do their dirty work, recruited other Liberians, mostly refugees, to help fight the first group.

Contraband smokes move effortlessly from country to country, and so do men with guns

To begin with, the government denied hiring Liberian mercenaries, but then both it and the Ivorian rebels agreed to kick the whole lot of them out of the country. The rebels have tried to do so, but the government has not. Inmates at a camp for Liberian refugees near the town of Guiglo said the army often came recruiting there. “Sammy”, a shy 17-year-old with a high-pitched voice, said he was given an AK-47 and some training, but no wages. Instead, he was told to help himself.

Almost 70km (43 miles) away, in Bangolo, people are unaware of their government's policy of encouraging foreigners to rob their homes, but they know the consequences. “They took our rice, our cocoa, our furniture,” said Marie Tieri, a local grandmother. “They threatened to kill me if I did not give them everything. And they took young girls to be their mistresses.”

The trouble is, Liberian auxiliaries are extremely useful to the government. Everyone fears them, not least because they are widely believed to have magical powers that make them immune to bullets. Even local university-educated UN officials are convinced of this. The only sceptic your correspondent met was Sammy, who shrugged: “I don't have no bulletproof.”

By the government's reckoning, 3,000 people have been killed during Côte d'Ivoire's war. Mass rape has caused HIV prevalence in the war zone to jump from 12% to 20%, by one estimate. Roughly 1.2m people have fled their homes. Pro-Gbagbo thugs, often in uniform, have been encouraging “foreigners” to leave. In one Abidjan slum, all that remains of the shacks where 2,500 immigrants once lived is a swathe of grassy wasteland. A former resident tells the story: “They came at midday, with bulldozers. They said we were sheltering rebels, which we weren't. Then they crushed our homes. What could we do? It was the army.”

For security reasons, Côte d'Ivoire's once-bustling highways are now clogged with road blocks. Driving from Abidjan to Bouaké, the rebel capital, a distance of 280km (175 miles), your correspondent counted 26. At every one, the police forced passengers off buses and made them form hour-long lines to have their papers checked. For some months, no goods trucks could cross the front line. Now a few big convoys are trundling across, but the service is slow and expensive, so northern farmers are paying more for their petrol and receiving less for their sugar.

Traders in Bouaké say they have never seen business so bad. “The banks are all closed, so no one has any money,” said Alassane Dumbia, a clothes-stall owner. Civil servants are still being paid, but they have to travel to the south to cash their pay-cheques, past those 26 road blocks.

The one benefit of war was that it temporarily drove up the price of cocoa, of which Côte d'Ivoire is the world's largest producer, without hurting production too much. But every other business has been knocked. Expatriates, mainly French, whose businesses pay roughly half the country's taxes, have left in droves. A once-flourishing tourist industry has evaporated. The beaches are deserted, the seafront hotels empty. The poor suffer most. “It is hard to farm”, notes Francis Banhiet, the mayor of Bangolo, “when they've taken all our machetes.”

What chance of peace?

AP

Both Liberia and Côte d'Ivoire are caught in a vicious cycle. Ethnic tension has fuelled war, which has further aggravated ethnic tension. Poverty has driven young men to pillage, which has made other young men (and everyone else) poorer. Pro-government militia leaders in Côte d'Ivoire, incensed that rebel chiefs in their early 30s have won seats in the cabinet by taking up arms, are tempted to follow suit. The government, which used to spend admirably little on the army so as to fund schools and hospitals, is now frantically buffing up its arsenal, leaving less for social spending and feeding rebel fears that it plans to go back to war.

To break the cycle will require political will, but neither side trusts the other. This week, the main Ivorian rebel group threatened to go back on an earlier promise to disarm, after a mob tried to kill its leader, Guillaume Soro, who is minister of communications in the so-called unity government. France, the UN and other West African states are trying desperately to get the two sides talking seriously to each other.

Meanwhile, in Liberia, Mr Taylor looks doomed. The neighbours he has injured are striking back, Guinea by backing the LURD and Côte d'Ivoire by backing the MODEL rebels. With the LURD controlling Liberia's diamond fields and MODEL at the gates of Buchanan, the main timber port, the rebels have succeeded in cutting his cash flow where UN sanctions failed.

Paddling for days to escape Liberia

If the rebels capture Monrovia, what kind of government might they form? No one knows. Neither group has committed Tayloresque atrocities, but both are alarmingly trigger-happy, and neither has a clear leader or any plan beyond ousting Mr Taylor. A Swiss businessman who fell briefly into the LURD's hands last month said he was well treated, but unnerved when the rebels started shooting at each other.

In Liberia, Mr Taylor looks doomed

If the capital falls, Mr Taylor might escape to his former fief in the east of the country. Arms are apparently being shipped out of Monrovia in preparation. There is a danger that Liberia could disintegrate completely, with the LURD controlling Monrovia and the north, MODEL the south, and Mr Taylor the east. On July 1st, Kofi Annan, the UN secretary-general, repeated his plea for America to intervene to prevent such a calamity. With even minimal American involvement, a robust force could probably be raised. France has said it will help, and West African states have pledged 5,000 troops.

He could learn from the French intervention in Côte d'Ivoire, which probably prevented a bloodbath, and from the British one in Sierra Leone, which restored a fragile peace. A surprisingly calm poll last year saw the re-election of President Ahmed Tejan Kabbah, who was forced to flee during the war, with over 70% of the vote. The rebel RUF's new political incarnation won less than 2%.

Freetown now looks relatively prosperous: smart bars and discos are mushrooming. But the boom is driven largely by the presence of 17,500 UN peacekeepers, the largest such operation ever. If they leave, as scheduled, next year, the boom could end, and Sierra Leone's security will be left in the hands of the army, which voted against Mr Kabbah. A coup attempt in January was put down, but its leader, a former army chief, escaped. In private, British officers charged with training the Sierra Leonean army are less optimistic than when they began, three years ago. Their pupils are still not as disciplined as they might be, and often wreck their shiny new British rifles by using them as ladders.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

California in crisis

Is the Golden State governable?

Jul 3rd 2003 | SACRAMENTO
From The Economist print edition

California's budget has gone bust. The state's system of government risks going the same way

> There has never been a comparable crisis in California's history, not even during the Civil War when people imagined California might become an independent country. In 1879, we had a crisis in the context of a small frontier society. Now we are talking about the fifth- or sixth-largest economy in the world in the context of globalisation. The crisis necessitates nothing less than the refoundation of our state.

THE Golden State has always had its share of people who have spent too long in the sun. This quotation, however, comes not from some shouting head, but from California's most respected historian and its official state librarian, Kevin Starr. Can his judgment be right?

The evidence comes from two simultaneous problems: California's failure to pass a budget, and an attempt to sack its governor. If California really were independent, the IMF would have been called in by now. This week, in an act of gross fiscal irresponsibility, legislators failed to pass a budget for the fiscal year beginning July 1st. It is not the first time this has happened, but the sheer scale of the shortfall—$38 billion over the next two years—makes the failure worse.

Meanwhile, Governor Gray Davis is preoccupied by something else. In California, petitioners can force a referendum on whether to remove a politician from office. A measure to “recall” Mr Davis seems likely to be on the ballot this autumn or next spring. This could be ominous for the state as well as for Mr Davis. If a governor who was re-elected only last year were recalled without evidence of malfeasance, it would set an ugly precedent for representative government. With the prospect of such rapid deselection, why should any Californian politician take risks, or take a break from fund-raising?

Both the recall and the budget can be partly explained away as special problems. The budget crisis is a delayed reaction to the dotcom bust (and the collapse in tax revenues). Mr Davis has been a disappointing governor, and the recall is essentially a political ruse by the Republicans to take advantage of that; the petitioning is being financed by a rich conservative, Darrell Issa, who wants to be governor himself. Yet both the recall and the budget are also symptoms of a more profound malaise in the state.

In 1911, California added three direct-democracy measures to its constitution: the initiative process (which allows voters to pass laws directly); the referendum (in which voters support or strike down laws passed by the legislature); and the recall. The heart of the current complaints about California's system of government is that direct democracy is now running amok and rendering the state ungovernable.

The two current challenges illustrate different aspects of this. Initiatives are supposed to be more authentic expressions of popular will than parliamentary laws: Proposition 13, the tax-cutting initiative passed 25 years ago which started the current bonanza, was a classic case of grass-roots volunteerism. The recall shows how much has changed. Running initiatives has become a big business in California. Companies collect signatures, send out mail shots and advertise. Some even guarantee to get a motion on the ballot. The going rate is $1m-2m for a statewide poll.

As a result, critics charge, it is too easy for millionaires to manipulate the agenda; too easy to get bad ideas on the ballot; too easy to have conflicting initiatives (in 1988, there were four competing ones on car insurance alone). And voters have too many decisions to take. Between 1980 and 2000, 626 statewide initiatives were circulated, 123 qualified and 52 passed—more activity than in the previous 70 years. In Los Angeles, there were 43 measures on the ballot in 2000, including local ones, plus dozens of elections for office holders. No one can make that many informed choices in one day, especially in a state where most political information comes in the form of 30-second advertisements, and where television stations barely notice local politics.

Initiatives have also bedevilled budget making. Proposition 13 halved local property taxes and required a two-thirds majority of voters to raise new taxes locally. Proposition 98, passed in 1988, said that 40% of the general fund must be spent on primary and secondary education. As a result, around 70% of state spending is earmarked in advance, difficult for the governor or legislature to change. This obviously makes balancing the budget harder, since discretionary spending must bear the burden of adjustment. It also makes it trickier for voters to hold politicians accountable for decisions, since most spending is determined by abstract formulae.

All the same, the initiative process is a mixed bag, not an unmitigated disaster. If initiatives were really as bad as the critics say, you would expect the state's voters to regret at least some of their decisions. Yet the initiative process gets rave reviews. Almost 70% of voters say it has been a good thing in general; only 24% think decisions by the legislature have been better than those taken through initiatives, compared with 56% who prefer initiatives.

There are several possible explanations for this continued level of support. Voters may simply be blind to their own failings. Propositions encourage voters to have it both ways: they normally either increase spending on a favourite subject (after-school teaching, for instance) or cut taxes. And the full impact may not yet be felt, even for Proposition 13: the effect of tax-limiting initiatives was muted during the 1990s boom. There is also some evidence that, though voters like the initiative process in general, growing numbers think it is in hock to special interests and in need of modest change.

But voters may also be making a reasonable judgment about the merits of law by referendum, compared with law by parliament. In the past ten years, California's voters have faced decisions on immigration (Proposition 187), term limits (140), affirmative action (209), campaign finance (73) and drug decriminalisation (36). Whatever one feels about the merits of the particular votes, these are legitimate subjects of public concern.

In contrast, at the federal level, there has either been little or no congressional action (immigration, term limits and drug decriminalisation). Or decisions have taken decades (campaign finance). Or they have come from the Supreme Court (affirmative action). There are plainly some issues that representative politicians will not touch, but voters want their say on.

Indeed, initiatives have often resulted from the failure of the legislature to act, rather than from pre-emptive action by angry voters. That was the case with Proposition 13 in the 1970s, when the notoriously disorganised Jerry Brown ran California. Of course, Proposition 13 is now a problem. But that could have happened without direct democracy—and may even one day be fixed by it.

On the budgeting side, representative government hardly looks perfect. Two-thirds of federal spending is non-discretionary—leaving Congress a little more room for manoeuvre than Mr Davis, but still showing how politicians can hem themselves in without ballot initiatives. Anyway, Congress is hardly a model of fiscal probity at the moment (see article).

The ballot initiatives also stop politicians raiding things that voters treasure. Without Proposition 98, the budget-writers would doubtless be trying to reduce education spending this year. Would that be a good thing? California's school system has declined from one of the best in the country in the 1960s to one of the worst. Public pressure for education spending would be strong regardless of Proposition 98.

Lastly, it is not clear that the most common objection to direct democracy really applies in California: that it encourages the tyranny of the majority. Checks and balances remain. The state Supreme Court has struck down parts or all of many initiatives (this is one of the commonest complaints of voters). And voters have on occasion corrected their earlier decisions. In 2000, they made it easier to raise money for education by allowing local authorities to issue school bonds with the approval of 55% of voters, rather than two-thirds, as required by Proposition 13. Initiatives are hard to change, but it can be done.

Bad politicians

Indeed, the bigger problem for California may be its representative institutions in Sacramento (or Disneyland North, as it is called). This is not a reference to the governorship. The fact that Mr Davis now faces people like Arnold Schwarzenegger trying to force their way into the governor's mansion has less to do with institutional malfunction (of any sort) than with Mr Davis's own style of governing. Risk-averse to a fault, he has refused to use the extensive powers of his office even while the budget descended into chaos. He has alienated his own party and the Republicans whom he trounced so recently have taken heart.

The institutional problem is in the legislature. As the budget crisis has shown, assemblymen have become incapable of deciding anything important, because California requires bipartisan co-operation at a time when such a thing no longer exists. California is one of only two states requiring a two-thirds “super-majority” of both houses to pass a budget. In a place as large and varied as California, you can hardly get a two-thirds majority for anything. Dan Lowenstein of the University of California, Los Angeles, thinks there is a case to reduce the current “idiotic” super-majority to, say, 55%. A proposal to do that may go on the ballot in March.

Initiatives are partly to blame for the paralysis. Proposition 13 introduced the super-majority. Proposition 62 extended it. Initiatives are also responsible for another feature that makes the Assembly unworkable: term limits. These may sometimes be desirable but in California they are simply too short. Proposition 140 set them at six years for Assembly members, eight for state senators.

As a result, representatives do not have a good grasp of the details of bills, have little long-term loyalty to the institution they serve and can sometimes be unduly influenced by more experienced lobbyists. No sooner do people become head of the assembly, or of an important committee, than they are term-limited out. Legislative leadership becomes almost impossible.

Like America only more so

The bigger problem is the remoteness of the politicians. Gargantuan voting districts mean that each state senator is supposed to represent 850,000 constituents. But California is an extreme case of something happening all over America. A combination of voter apathy and partisan redistricting—the ability to draw constituency boundaries to make seats safer—has made politicians more responsive to table-bangers than to voters.

California's Democrats show more interest in the rights of transgendered citizens or whales than, say, Latinos. The Republicans' leader in the Senate, Jim Brulte, threatened to campaign against any party member who voted for tax rises to solve the budget crisis (even though tax rises are inevitable). Partisan loyalty is more important than solving a statewide crisis.

The real flaw in California is not a mechanical one to do with how smoothly the machinery of government is working (though it plainly isn't doing very well). The real problem is that politicians have become divorced from the changing nature of their state.

California has taken in over 11m people in the past decade, from other parts of the United States and from Latin America. It is one of America's great engines of assimilation and of job-creation. Yet the “new” Californians—Latinos, other immigrants, people under 25—are the least engaged by politics. For this

failure of political assimilation, California's indirect democracy is just as much to blame as its direct kind.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Supreme Court

We'll make up our own minds

Jul 3rd 2003
From The Economist print edition

The country's top judges aren't as predictable as politicians like to think

Get article background

THERE can no longer be any doubt. William Rehnquist, chief justice of America's Supreme Court, definitely enjoys a joke. In the final moment of the last day of this year's court term, on June 26th, he declared from the bench that he had a retirement to announce. Spectators held their breath. Rumours had been swirling for months that one of the court's nine justices would retire at the end of the 2002-03 term. Had the moment finally arrived? No. The court's librarian, Justice Rehnquist intoned with a straight face, was planning to step down after 15 years.

Some in Washington undoubtedly breathed a sigh of relief, not least President George Bush. If one of the justices had retired, Mr Bush faced an unpalatable choice. Nominating a candidate with strong conservative views would have pleased the right wing of his party. But it would have miffed many moderate Republicans, and delighted the Democrats, who would have tried to use a bitter confirmation battle to rally their own core supporters and to reach out to uncommitted voters before next year's presidential campaign. On the other hand, if Mr Bush had nominated a moderate, or even a candidate without proclaimed conservative views, the right would have been furious.

Although a confirmation battle now seems unlikely this year, or during next year's election campaign, it cannot be ruled out. Nothing says when a justice can retire. Either Justice Rehnquist or Justice Sandra Day O'Connor, the main targets of speculation, could leave after the court issues its ruling on the McCain-Feingold campaign-finance law, for which it is holding hearings in a special session early in September. Illness or death might intervene. The current justices have been together longer than any other nine-member court since 1823. Justice John Paul Stevens is 83, Justice Rehnquist is 78 and Justice O'Connor is 73.

In the final week of the court's term, it delivered two bombshells for conservatives. By a 5-4 margin it upheld the idea of affirmative action in university admissions—in effect, selection by race. This decision only allows the use of affirmative action, it does not require it. Opponents of the policy are now likely to turn to legislatures and referendums, where they could have more success.

The court's other decision—striking down by 6-3 a Texas law criminalising homosexual sodomy—is even more of a landmark. Five of the six justices in the majority signed an opinion broad enough to open the way eventually to homosexuals' claiming all the rights enjoyed by heterosexuals, including marriage and adoption. *Lawrence v Texas* could become as important for homosexual Americans as *Brown v Board of Education*, the 1954 decision outlawing racial segregation, proved to be for black Americans.

The fact that the Rehnquist court ended this term with decisions so pleasing to liberals illustrates what an unpredictable political instrument the Supreme Court can be. Seven of the current nine justices were appointed by Republican presidents. Four of these were appointed by Ronald Reagan, a conservative hero, if Justice Rehnquist's elevation to the chief justice's job is included (he was originally appointed to the court by Richard Nixon).

There is no question that these Republican appointments have had some effect. The Rehnquist court has moved to the right on many issues, chipping away at rulings by the earlier liberal court led by Chief Justice Earl Warren (himself a Republican appointee and former Republican governor) on civil liberties, criminal justice and in other areas. It has also tried to curb federal power in favour of states' rights, a perennial conservative cause.

But it has not launched the full counter-revolution many conservatives had hoped for. Once on the court, the current crop of justices, like those in the past, have proved stubbornly independent. Most have been rightly more concerned with legal issues than with broad political programmes. The two swing justices who have had the most influence on the court, restraining its most conservative members and sometimes siding with the moderate-liberal minority, are Justice O'Connor and Justice Anthony Kennedy, the author of last week's gay-rights ruling. They were both Reagan appointees.

It seems clear that evangelical Christians and other social conservatives will find it hard to win the guaranteed changes they seek to the nature of this particular Supreme Court, and especially to overturn the *Roe v Wade* abortion ruling, their most sought-after prize. To achieve these goals, they surely need the appointment of not merely a conservative jurist to the court, but one with a declared ideological agenda matching their own.

But that is precisely the kind of nominee who will be most bitterly opposed not only by Democrats but also by Mr Bush's electoral strategists. Swing voters like suburban soccer moms tend to object to abortion being banned. Perhaps nominations to the court are not the most useful vehicle for pursuing ambitious political goals, for either conservatives or liberals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Wesley Clark

General Electric?

Jul 3rd 2003 | LITTLE ROCK
From The Economist print edition

Will the former NATO chief run?

DO THE Democrats really need a tenth presidential candidate? Especially one with little political experience and not much money, who may not be a Democrat anyway? Well, these days a good military record and a lantern jaw go a long way.

On July 7th some 500 groups across the country will gather in coffee bars and libraries to talk about why General Wesley Clark should be the next president of America. In the past few weeks, a number of “Blue Dog” southern Democrats have come calling on the former commander of NATO at his Little Rock home with the same idea. And various union groups have asked Mr Clark to come and talk to them.

Famous generals have a habit of flirting with campaigns, without actually running (remember Colin Powell?). But people in Little Rock think it increasingly likely that Mr Clark will take the plunge. The general has been acting like a prospective candidate, making speeches around the country and pontificating on the television about global affairs. He has also launched his own website (leadershipforamerica.org). And conveniently enough, he has written a new book (on Iraq and terrorism) which comes out in September, around the time that the primaries start to heat up.

The general does however lack certain things. The most obvious is a party affiliation. Given how often he bashes George Bush, it is hard to believe he is a Republican. He also supports affirmative action and abortion rights. Assuming he is a Democrat, a bigger problem is organisation. His supporters point out that Bill Clinton didn't formally enter the race till October 1991. But Mr Clinton had an established political operation. Mr Clark's rivals are already raising money, and they have hired staff who know the intricacies of Iowa and New Hampshire.

Mr Clark's people talk about grassroots support. One vehicle for raising money is an official “draft Clark” campaign (from which the general tends to keep an appropriate amount of distance). People at the coffee meetings next week, who have been rounded up by e-mail, will be asked to put their wallets where their modems are.

If he does declare, Mr Clark would face a tough fight. Howard Dean is already having great success wooing the sort of independent Democrats Mr Clark would want to lure, John Edwards is chasing conservative southerners and John Kerry has some military experience. On the other hand, the general might be good vice-presidential material. They also said that about Mr Powell.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The South

My, how you've changed

Jul 3rd 2003
From The Economist print edition

Three recent deaths are a reminder of how long it took the South to desegregate, how huge were the consequences, and how commonplace they now seem

MAYNARD JACKSON, Lester Maddox and Strom Thurmond, who died within a few days of each other at the end of June, were all southern politicians. Two were born into relative affluence (Jackson and Thurmond), two took to the grave the opinions they had held in office (Jackson and Maddox), and two were white (Maddox and Thurmond). All exemplified the transformation of the American South that occurred between the mid-1960s and the mid-1970s, a transformation now largely taken for granted.

By some measures Mr Jackson had the most privileged background. His father, a Baptist minister, came from an influential family in Dallas, his mother from another in Atlanta; both parents had been university educated. But their privilege did not extend to the right to vote, nor to sit at the front of buses, nor to eat lunch at counters next to whites. It was 1964 before the Civil Rights Act was passed and 1965 before the Voting Rights Act followed. The second act was the more important: among other things it enabled previously disfranchised blacks in 1973 to elect Mr Jackson as mayor of Atlanta, with the help of a fifth of the white voters, and thus to become the first black mayor of a major southern city.

Mr Jackson served three terms, from 1974 to 1982 and from 1990 to 1994. His greatest achievement was to enlarge Atlanta's airport—at which, it is said, all journeys to heaven or hell involve a change of plane—on time, on budget and with a programme that vastly expanded the number of city contracts given to black firms.

It was precisely to prevent such changes that Lester Maddox went into politics. The son of a poor steelworker who completed his high-school education by correspondence, he became governor of Georgia in 1967 on a platform of unabashed segregation in the populist tradition. He had risen to notoriety in 1964 by refusing to serve three black students, testing their newly won civil rights, at his fried-chicken restaurant in Atlanta. To reinforce his point, he provided pick-axe handles that like-minded customers would brandish and that he would later autograph for racist fans.

But Mr Maddox was unable to hold back the tide of desegregation, and he achieved little during his term of office. He mellowed to the extent of promoting some blacks in state government and saying that forced segregation was wrong, but he insisted to the end that forced integration was also wrong.

Strom Thurmond was a more adaptable—some might say less principled—politician. Latterly famous mostly for his great antiquity (he died at the age of 100, having retired from the Senate last January after 47 years' service there), he campaigned as a mild progressive in the 1946 governor's race in South Carolina. The son of a judge, “he did not indulge in the usual type of Negro-baiting”, wrote V.O. Key, the great chronicler of southern politics. But he was soon building a career on keeping blacks in their place (“I wanna tell you...that there's not enough troops in the army to force the southern people to break down segregation and admit the nigger race into our theatres, into our swimming pools, into our homes and into our churches,” he declared in 1948). He entered the record books in 1957 by conducting the longest filibuster ever on the Senate floor, a speech that lasted 24 hours and 18 minutes, in an effort to block a civil-rights act.

Unlike Mr Maddox, Mr Thurmond saw the way events were going and later started to take blacks on to his staff, back them for federal judgeships and generally abandon his previous racial attitudes. But the vehemence of his opposition to civil rights—it was the main reason for his decision to run for the presidency as a Dixiecrat in 1948—called into question his conversion and contaminated his other views.

When he left the Democratic Party in 1964 to become a Republican, he did not do so as a moderniser

who wanted to bring southern politics out of its fetid, one-party backwater. Mr Thurmond certainly helped to build up the Grand Old Party in the South; indeed, the Republicans now rule most of it. But he gave this conversion a racist Dixiecrat slant; the more enlightened mountain Republicanism of Tennessee was sidelined. His legacy is one of ineffective reaction, not reform.

The South has reformed, though. It has long since ceased to occupy the lower “levels of civilisation” in which H.L. Mencken put it in the 1920s and where it stayed for another 50 years. On the contrary, on some measures it is now in the van. But it took a long time to get there. The wait was so long—a full century passed after Robert E. Lee's surrender at Appomattox in 1865 before the South would rise again—for just one reason: race.

Race kept the South fixed in economic backwardness and one-party politics, and only with the liberation of southern blacks could the liberation of southern whites follow. That it has done so with such success owes more to people like Maynard Jackson than to those like Lester Maddox and Strom Thurmond.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Latter-Day Saints

Go east, young Mormon

Jul 3rd 2003 | NAUVOO, ILLINOIS
From The Economist print edition

Where Joseph Smith ended, and Brigham Young resumed the journey

AS YOU will know if you have ever thirsted for a nip of alcohol in Utah, the Church of Jesus Christ of Latter-Day Saints has great influence in certain western states. Now some Mormons are heading back to the east, whence they originally came. Although there are far fewer of them in Nauvoo than in the Utah desert, a recent influx is transforming this tiny town on the Mississippi River in ways that are oddly reminiscent of the 1840s.

Unknown though it may be to the rest of the world, Nauvoo looms large in the Mormons' history. Joseph Smith, their first president, led his followers here in 1839 to escape persecution. An industrious lot, they drained the swampland and founded a settlement that grew to 12,000 people, making Nauvoo the second-largest city in Illinois. Missionaries set out from here to places as far away as the South Pacific.

In 1841 construction started on a Greek-style temple on a bluff overlooking the settlement. But before the temple was completed, in 1846, the Mormons were in trouble again. Whatever the cause—the fact that Smith had at least 33 wives was doubtless part of it—the locals took against them. Smith was killed by a mob in a nearby town in 1844. Enter Brigham Young, who in 1846 led thousands of the Latter-Day Saints on a 1,300-mile trek west from Nauvoo to Utah's Salt Lake valley. Only a few Mormons stayed behind, and the temple was destroyed.

Today Nauvoo has a population of about 1,000, no traffic lights, and a farmer as its mayor. Yet the stream of tour buses heading into town on most summer days makes it clear that times are changing. Small groups of Mormons began coming back in the 1960s. Just over a year ago, on June 27th 2002, a big new Mormon temple was dedicated on the site of the original. More than 330,000 visitors arrived in a two-month period. The temple's exterior is almost (but not quite) a duplicate of the original. As for the temple's inside, well, non-Mormons will have to watch a video.

Lots of tourists, mostly Mormons, continue to arrive. They are not retracing their ancestors' route on foot; many of them turn up in giant caravans. There are also hundreds of missionaries—earnest college-age children and retired couples—not only from Utah but also from California, rural Wyoming and even Las Vegas. The missionaries do six to 18 months of service in Nauvoo as guides at the visitors' centre, singers in the three nightly musical reviews, or reliving in period costume the fun their forebears had toiling at the old-time bakery, brickyard and boot shop. Polygamy is no longer a big issue: it was banned by the church long ago, though a handful of rebels still practise it.

Not everyone in Nauvoo is thrilled by all this. The traffic has caused headaches for the two-man police force. The Mormon church, needing to house all those missionaries, snapped up some local properties at $200,000-$300,000 apiece, an eye-popping price in these parts. There is an argument about how much church property should be taken off the local tax rolls. And, of course, there is politics. Nauvoo has long been a Democratic town, but Mormons are overwhelmingly Republican.

Some non-Mormons accuse the newcomers of clannishness. Dottie Herbert, who has run a local diner for 35 years, says that Mormons have been told to avoid her place because it serves alcohol (they also abstain from caffeine and tobacco). There are shopkeepers who say that some tourists turn and walk out when they learn a business is not Mormon-owned. There are also charges of proselytisation. Hopeful Mormons, it is said, visit the Roman Catholic church in search of possible converts. “They look around, leaf through our books,” says one suspicious Catholic.

Most locals, however, seem more enthusiastic. It is hard to imagine a more polite set of tourists than the Mormons. And now that the local blue-cheese factory has closed down, taking 60 jobs with it, the people

of Nauvoo appreciate the business.

The Mormons were not the only carriers of new ideas to discover Nauvoo. In 1849 a group of European utopians called the Icarians occupied the abandoned Mormon settlement. They were led by a Frenchman, Etienne Cabet, and the influence of old Europe began to make itself felt. Illinois's oldest winery, Baxter's Vineyards, was founded by one of Mr Cabet's followers in 1857.

The Icarians, too, soon moved on. But Baxter's vineyard remains. After sipping several wines, your correspondent settled for a bottle of Lusty White. A Mormon sitting nearby virtuously abstained, but then leaned over: “Don't tell Baxter's, but some of their best customers are Mormons.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Human rights and terrorism

The pledge

Jul 3rd 2003
From The Economist print edition

George Bush says that America does not use torture

IT'S official. The United States government does not torture anyone, including terrorist suspects. It does not subject them to “cruel, inhuman or degrading treatment” which falls short of torture. Nor does it transfer them to other countries to be tortured. Any American official caught doing these things will be held legally accountable.

“The United States is committed to the worldwide elimination of torture and we are leading this fight by example,” declared President George Bush in a proclamation issued on June 26th, the UN's day for torture victims. A day earlier, William Haynes, general counsel to the Department of Defence, had sent a letter spelling out these commitments to Patrick Leahy, the ranking Democrat on the Senate Judiciary Committee.

Mr Leahy had written to Condoleezza Rice, Mr Bush's national security adviser, with a list of detailed questions about American policy after a series of news reports which quoted anonymous American officials claiming that terrorist suspects were being subjected to “stress-and-duress” interrogations that, in effect, amounted to torture, or were being tortured outright. Other suspects, they said, were handed over to countries known to use torture.

Is the American government torturing terrorist suspects or not? It is difficult for anyone outside the government to know for certain. American officials claim to have detained thousands of suspects, including some senior al-Qaeda leaders, but will not say where, and under what conditions, they are being held. Nevertheless, human-rights groups were pleased to welcome the statements of Mr Bush and the Pentagon's Mr Haynes. The official policy is clear. No American interrogator will any longer be able to claim that he had a wink and a nod from higher-ups to use torture.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

Red George

Jul 3rd 2003
From The Economist print edition

Meet America's most profligate president since the Vietnam war

MOST people only have to see the word Medicare and they turn the page. Please resist, just this once. There are few better ways of understanding America's emerging Republican establishment than studying the two Medicare bills that are currently working their way through Congress.

These bills point to two conclusions that are worth pondering by people who don't give a fig about co-payments. The first is that the Republicans are mighty shrewd when it comes to short-term political manoeuvring. The second is that they are almost completely indifferent to the basic principles of sound finance.

Start with the politics. Ever since Lyndon Johnson introduced Medicare in 1965 as one of the edifices of his “Great Society”, Democrats have been taunting the Republicans as hard-hearted bastards who don't give a damn about the elderly. What better way to shut the Democrats up than a new $400 billion drugs benefit? Congress still has to reconcile the Senate and the House versions of the bills, a procedure that could take until the autumn. But few people doubt that the law will eventually pass—and that Mr Bush will enthusiastically sign it. This will also reinforce the Republicans' claim that they are better at getting things done than Democrats (who, in Republican lore, ran Congress for decades without doing anything about drug prices).

Nice Bill Frist, the do-gooding doctor who replaced Trent Lott as Senate majority leader, will be able to boast that he has passed a major Medicare reform within a year of taking up the job. Mr Bush will be able to go into the next election armed with yet more proof that he is both a “compassionate conservative” and a “reformer with results”—a man who has not only toppled the Taliban and Saddam Hussein but also reformed education and Medicare. Republicans are already bragging that Mr Bush's embrace of Medicare reform is the same as Bill Clinton's embrace of welfare reform back in 1996—a manoeuvre that magically transforms a liability into a strength.

There is, however, one tiny difference. Welfare reform was an admirable policy that led to a sharp reduction in welfare rolls. Medicare reform is lousy policy. The Republicans have given up any pretence of using the new drug benefit as a catalyst for structural reform. They are doing nothing to control costs or to target government spending on people who really need it. They are merely creating a vast new entitlement programme—a programme that will put further strain on the federal budget at just the moment when the baby boomers start to retire.

This might be tolerable if the Medicare boondoggle were an isolated incident. But it is par for the course for this profligate president. Every year Mr Bush has either produced or endorsed some vast new government scheme: first education reform, then the farm bill, now the prescription-drug benefit. And every year he has missed his chance to cut federal pork or veto bloated bills.

As Veronique de Rugy of the Cato Institute points out, federal spending has increased at a hellish 13.5% in the first three years of the Bush administration ("he is governing like a Frenchman"). Federal spending has risen from 18.4% of national income in 2000 to 19.9% today. Combine this profligacy with huge tax cuts, and you have a recipe for deficits as far ahead as the eye can see.

Why has the self-proclaimed party of small government turned itself into the party of unlimited spending? Republicans invariably bring up two excuses—the war on terrorism and the need to prime the pump during a recession; and then they talk vaguely about Ronald Reagan (who sacrificed budget discipline in order to build up America's defences).

None of this makes much sense. The war on terrorism accounts for only around half the increase in spending. The prescription-drug entitlement will continue to drain the budget long after the current recession has faded. As for Mr Reagan, closer inspection only makes the comparison less favourable for Mr Bush. The Gipper cut non-defence spending sharply in his first two years in office, and he vetoed 22 spending bills in his first three years in office. Mr Bush has yet to veto one.

Ronald Reagan wouldn't

The real reasons for the profligacy are more depressing. Mr Bush seems to have no real problem with big government; it is just big Democratic government he can't take. One-party rule, which was supposed to make structural reform easier, also looks ever less savoury. Without a Congress that will check their excesses, the Republicans, even under the saintly Dr Frist, have reverted to type: rewarding their business clients, doling out tax cuts and ignoring the fiscal consequences.

This opportunism may win Mr Bush re-election next year, but sooner or later it will catch up with his party at the polls. The Republicans are in danger of destroying their reputation for managing the economy—something that matters enormously to the "Daddy Party" (which sells itself as being strong on defence and money matters). The Democrats can point out that Bill Clinton was not only better at balancing the budget than Mr Bush. He was better at keeping spending under control, increasing total government spending by a mere 3.5 % in his first three years in office and reducing discretionary spending by 8.8%.

The Republican Party's conservative wing stands to lose the most from this. Some conservatives credit Mr Bush with an ingenious plan to starve the government beast: the huge tax cuts will eventually force huge spending cuts. But this is rather like praising an alcoholic for his ingenious scheme to quit the bottle by drinking himself into bankruptcy. There is no better way to stymie the right's long-term agenda than building up the bureaucracy (government being a knife that only cuts leftwards). And there is no better way to discredit tax cuts than to associate them with ballooning deficits. For the moment Mr Bush is still the conservatives' darling. Will they still love him a decade from now?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Race in Brazil

Out of Eden

Jul 3rd 2003 | RIO DE JANEIRO
From The Economist print edition

Corbis

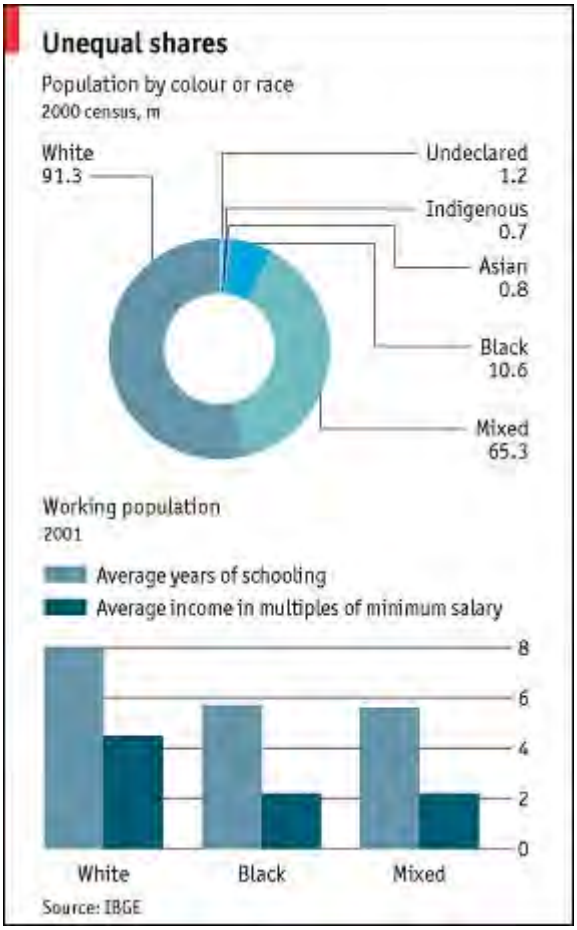
Brazil used to think it could be colour-blind. Alas, no longer

JOANA, an actress and student, is white, or at least that is what her birth certificate says. She has a white father, a mixed-race mother and skin the colour of cappuccino. But she considers herself to be “more or less black”. Joana's ambiguity about her race is quintessentially Brazilian. Brazil had slavery, but never apartheid or the formal segregation of the American south. Centuries of interracial coupling have produced a population that is 40% *pardo* (mixed). But Joana's description of herself as “black”, or *negra*, belongs to a new era in Brazil's racial politics. It implies that racial mixing has done nothing to correct racism, that *pardos* and *pretos* (the census term for blacks) are in the same boat and that the solution is not to ignore race but to plant it at the centre of policies to overcome vast social and economic inequalities. Though most people are only dimly aware of it, their idea of what it means to be Brazilian is about to be challenged.

The challenge is coming through racial quotas, which black leaders see as an indispensable corrective to discrimination. They are not widely used yet, but they are spreading. Three federal ministries recently introduced quotas of 20% for blacks in senior jobs. A handful of cities in São Paulo, the industrial heartland, have introduced racial quotas in the past two years. Most contentiously, so have a few public universities, the institutions that decide who will be admitted to Brazil's elite. Congress is considering a “statute of racial equality” that would give quotas a big extra push. These and other affirmative actions add up to a “revolution” that is “much bigger than people imagine,” says Ivair dos Santos, advisor to the federal secretary for human rights.

As in South Africa, race is central to Brazil's idea of itself. But instead of strife, the country has myths of hybrid harmony. An early 20th-century notion that Brazil was gradually “whitening” through miscegenation (thought to be a good thing) gave way to the idea that African elements enrich the mix. Many Brazilians think they live in a “racial democracy”.

It was never that, today's black leaders bitterly assert. Justice will come only through quotas, which set targets against which performance can be monitored. Resisters, they insist, are simply defending a white monopoly of power and riches. That may be true of some, but there is more to it. Some campaigners for equality fear that quotas will make racism worse. “We had a goal to have a society that didn't look at people in racial terms,” says Yvonne Maggie, an anthropologist at Rio de Janeiro's Federal University. “Now we are creating a race question.”



The serpents in this tale of lost innocence are social scientists. For two decades they have shown that blacks are at the bottom of every heap, with less schooling, lower incomes and higher rates of poverty than whites (see chart). Although poverty is skewed regionally as well as racially, blacks in poor regions are poorer than whites; they earn 30% less than whites with similar education. In most respects, *pardos* are as badly off as the 6% of the population that declares itself *preto*. “No one listened when we said there was a race problem,” says Umberto Alves of the Movimento Hip Hop, which mixes social work and music. Now they do “because the statistics show it.”

Brazil's informal racism has not created a popular civil-rights movement of the sort that rallied black and white Americans during the 1960s. Brazilian racism is like a gun at the back of the head rather than one pointed between the eyes, says José Vicente, president of Afrobras, an NGO. Instead it has created a black movement, composed largely of activist NGOs, which is lobbying government with increasing success. Brazil's former president, Fernando Henrique Cardoso, a sociologist whose work helped puncture the myth of racial democracy, introduced quotas into the federal administration. As the idea spreads, sympathetic whites are growing uneasy.

Nowhere more so than in the universities. Just 2% of the students at public universities, generally the best, are *negros*, black activists claim. The entrance exam, the *vestibular*, is a “game played with marked cards,” claims Frei David Santos of Educafro, a group that prepares black students for university. But to others the system represents a shining exception to what Brazilians call *panelinha*, the habit of giving preference to one's connections. Eunice Durham, of the Centre for Higher Education Research at the University of São Paulo, calls the *vestibular* a “democratic victory”. She cites research showing that a fifth of students at public universities are black or *pardo*. Her alternative to quotas: a broad affirmative-action programme including scholarships and subsidised pre-*vestibular* courses for blacks and poor whites.

The black movement seems to be winning the argument. In Rio de Janeiro a populist governor brought in a law obliging the main state university to reserve 40% of its places for blacks and half for graduates of state high schools (which, unlike state universities, are for common folk).

The experiment, now in its first year, has had mixed results. It has stirred up a national debate about racial injustice, the “best impact”, says a university official, and apparently encouraged more poor students to apply. Yet it is proving to be a clumsy solution to a complex problem. *Negros* and/or graduates of state schools filled two-thirds of the places; two-fifths were filled with students who qualified solely because of the quotas. In the much sought-after industrial-design department, 78% of

places were filled by quota. Rich blacks and graduates of the few elite state schools benefit most. A third of the blacks admitted, for example, had household incomes of about 2,000 *reais*, or $700, a month—at least ten times the minimum wage. Frei David alleges that half the successful candidates for black places declared themselves *pardos*. The solution he proposes shows how much quotas could change Brazilians' sense of who they are: in doubtful cases a commission would verify students' racial identity, overthrowing the idea that a person's race is what he says it is.

Rio's quotas may now be scaled back (to 20% for blacks and 20% for public-school students) but the principle is taking hold. The University of Brasília recently adopted a 20% quota for blacks, the first federal university to do so.

The further spread of quotas depends largely on Luiz Inácio Lula da Silva, Brazil's president. He has named the first black judge to the Supreme Court and appointed a cabinet-level advisor on racial inequality. It is not clear whether he backs the proposed racial-equality law, which would expand quotas greatly. It suggests 20% quotas for “Afro-Brazilians” in government jobs and public universities, enterprises with more than 20 employees and among actors in television programmes; 30% of political parties' candidates would have to be black.

Without such quotas, black leaders say, Brazil risks social upheaval. Mrs Maggie of Rio's Federal University counters with snapshots: she shows visitors group photographs of aspiring university students, all poor enough to have their *vestibular* fees waived, and asks them to pick out the blacks. It is impossible, for they vary in tone from coffee-dark to milky white. Quotas, she warns, will assign them labels and turn them against each other. Brazil now knows it has a race problem, but is wondering how to solve it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Mexico's elections

El Norte gets a voice

Jul 3rd 2003 | CHICAGO AND MEXICO CITY
From The Economist print edition

And Mexico's left may benefit most

THE building used to house the Polka Hall of Fame; but now the Zacatecan Cultural Centre, on Chicago's South Side, has become a social hub for many Mexican migrants. Maids, gardeners and factory workers by day, at night they slip into their best outfits for dances, raffles and family celebrations with their fellow ex-pats from the state of Zacatecas. A couple of weeks ago, the centre hosted a special event: an election rally. Not for an election in America, but in Mexico.

The speaker was Manuel de la Cruz, a congressional candidate for the leftist Party of the Democratic Revolution (PRD). He is one of several dual-nationality candidates the PRD is fielding, three of them from Chicago. “My home may be here, but my heart is in Mexico,” says the aspiring *diputado*. He is running for one of the 200 “at-large” seats in the Mexican federal congress, selected by proportional representation, which are up for grabs in the mid-term elections on July 6th.

Most of the people who listened to Mr de la Cruz will not be voting in the election. Although many have kept their citizenship, Mexican law requires that they go back home to vote. But they will certainly have an influence on the elections, by calling friends and family in their towns and villages. Up to 23m people of Mexican descent, about 3m-5m of them undocumented, are now living in America, and perhaps half of them are still able to vote at home. Last year, they sent back about $11 billion in remittances. Not surprisingly, Mexican politicians are trying to mobilise them. Only this week, Vicente Fox's government pledged to pass legislation to enable all Mexicans abroad to vote in the 2006 presidential election.

The state of Zacatecas, in the centre of Mexico, has emerged as a leading force in the organisation of migrants abroad. Mr de la Cruz was born there. With about as many Zacatecanos—1.5m—living in the United States as in the state itself, there is a clear incentive to build strong ties. The PRD governor of the state, Ricardo Monreal, frequently visits American cities with large migrant populations. He also raised about half the funds needed to purchase and renovate the cultural centre in Chicago.

In 1998 Mr Monreal asked Mr de la Cruz, who was elected president of the Federation of Zacatecano Clubs in the United States in 1991, to become the state government's man in America. The federation has been a leader among such organisations in sending back money for roads, bridges and schools. And since the migrants feel that they are doing so much for Mexico, Mr de la Cruz and his supporters now want an official voice in politics back home. After all, Mr Fox himself has described them as heroes.

A Mexican citizen living in America was elected for the former ruling party, the Institutional Revolutionary Party (PRI), in 2000, but no one knew his circumstances until after the event. This is the first time that dual-nationality candidates have run openly, and the PRD—a small, left-wing party that polls only about 17% in Mexico— hopes to profit by them. Neither the ruling National Action Party (PAN) nor the PRI is fielding American-based candidates in this election, because they were uncertain of the exact legalities of doing so.

But as one of the PRD's leaders, Javier Hidalgo, points out, most of the migrants are from the poorer Mexican states, such as Oaxaca, Guerrero and Zacatecas itself. These people have gone north to escape real poverty. And these states are where the PRD traditionally does best. Mr Hidalgo speculates that, one day, there might even be *diputados* in the Mexican Congress representing dedicated voting districts in America. That might really shake up domestic Mexican politics.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Argentina

First blows

Jul 3rd 2003 | BUENOS AIRES
From The Economist print edition

Néstor Kirchner makes his presence felt—up to a point

Get article background

WHEN the boss of the International Monetary Fund, Horst Köhler, came to Buenos Aires last week, Argentina expected a roasting. Instead, the roasting was on the other side. The new president, Néstor Kirchner, bluntly told Mr Köhler that his priority was economic growth, not fiscal stringency, and that Argentina would not sign any deal it could not fulfil. “You are greatly responsible for what happened in Argentina,” he told his visitor.

Mr Köhler, chastened, declared that he had been impressed by the Argentine president and his vision of growth with social equality. “I don't want to be the scapegoat,” he declared. “But I accept that perhaps we underestimated [the problem]. We should listen more to Argentines.”

Mr Kirchner seems to be having this effect on almost everyone. Having won the presidency by default, and with just 22% of the vote, he pulled no punches in his first weeks. He purged the top ranks of the army and police, started a clean-up of the notoriously corrupt pensioners' health system and drew blood last week, in his noisy campaign to reform the Supreme Court, with the resignation of the court's president, Julio Nazareno.

As a result, Mr Kirchner's popularity rating now stands at nearly 80%. But he should not let this go to his head. His targets have been safely inside his executive remit, and most are unpopular. (The Supreme Court justices, most of whom owe their loyalty to the man he defeated, Carlos Menem, are widely reviled.)

Luís Tonelli, political analyst for IPSOS-Mora y Araujo, a pollster, also doubts that the president will be able to transform his current ratings into gains within the ruling Peronist party that is dominated by his predecessor, Eduardo Duhalde. Local and congressional elections are taking place this year; and although the divided Peronist block in Congress has started to unite around the president, the party has refused to back his preferred choice of mayor in the capital, or to reopen its list of congressional candidates in Buenos Aires province to include his supporters. Mr Kirchner will have to rely heavily on his popularity with the public, but that is bound to fade. As Mr Tonelli puts it, “Other presidents who were just as popular eventually went to hell.”

The president's prospects depend, above all, on improving matters for the six out of ten Argentines who are now poor. Some things are in his favour: prices for Argentina's farm exports have picked up, and the economy, having pulled out of a four-year slump in 2002, was expected to grow by around 5% this year. But the latest indicators show growth may be slowing. And there are difficult—and unpopular—economic decisions ahead. An interim IMF loan agreement runs out in August, and both sides want a longer-term deal.

But according to Luís Secco, an independent economist, that will require resolving the problems postponed by the previous government: sorting out the banking system, renegotiating the country's foreign debt and reopening contracts with the privatised utilities. In that regard, Mr Secco reckons Mr Kirchner has overestimated the support he will receive from the United States and European countries, who helped pressure the IMF into the current short-term deal. “Before, the idea was to help Argentina last out until elections were held,” he says. “Now there is a democratically elected government, [it] is going to be expected to do things...Köhler smiled more this time, but the demands are the same as ever.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Vancouver and the Winter Olympics

Somewhat cool

Jul 3rd 2003 | VANCOUVER
From The Economist print edition

Will the 2010 games do British Columbia any good?

AFP

The IOC's man hits the slopes

ON JULY 2nd, 50,000 flag-waving British Columbians packed BC Place Stadium, in downtown Vancouver, to cheer the decision of the International Olympic Commission to award Vancouver-Whistler the 2010 Winter Olympic Games. Whistler, high in the Rockies two hours' drive to the north-west, is where the games will take place, but it is British Columbia that will win or lose.

The crowd in the stadium looked eager enough. In fact, Vancouver's victory (over Pyeongchang in South Korea and Salzburg in Austria), was achieved with decidedly lukewarm support at home. A bid-committee poll of Vancouverites found 62% in favour; and 64% of residents voted for the games in a city-wide plebiscite. But a poll by the International Olympic Committee (IOC), which covered the whole province, found only 58% of British Columbians in favour, with 25% against and 17% uncertain.

The bid has been dogged by controversy. The provincial economy is limping, and the government is burdened by debt. Budget cuts have caused most pain in the small inland towns. Worst of all, the government wants to privatise the Coquilhalla Highway to the interior (the only one which has long since been paid for) and retain the tolls for another 55 years. Given all that, spending millions on the Olympics goes down badly.

Nor do many Vancouverites, except hotel and restaurant owners, imagine the games will do them good. In opponents' minds, the Olympics mean mostly debt and higher taxes; Montreal, after all, has only just paid off its debt from the games it hosted in 1976.

But the boosters, led by the mustard-keen premier, Gordon Campbell, see the games as a massive economic jump-start for the province. They trot out huge and speculative numbers, including 228,000 direct and indirect jobs and increased tax revenues of up to C$1 billion ($740m). New sports facilities will be left behind, as well as better transport: a wider Sea-to-Sky Highway from Vancouver to Whistler, and a new rapid-rail link between the central city and the airport. Sometimes boosters even mention the fillip the games will give to Canada's athletes.

What Mr Campbell and other supporters are really hoping for, however, is a replay of the success of Expo'86, the world-transport exhibition. Expo'86 earned Vancouver global attention, bringing a decade-long boom in investment and a huge inflow of residents. There were doubters then, too; but after opening day, most of the doubters turned into fans.

Could it happen again? Expo'86 triumphed with excellent design and superbly efficient management. If Vancouver's Winter Olympics turn out the same way, the locals may find themselves truly enthusiastic in February 2010. If.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hong Kong and China

For freedom

Jul 3rd 2003 | HONG KONG
From The Economist print edition

James Miles

Half a million people show how unpopular China's man in Hong Kong has become

Get article background

NEVER in Hong Kong's history have so many people taken to the streets in protest against their own government. As many as half a million marched through the territory's central business and commercial district in stifling heat on July 1st, compared with at most a few tens of thousands who have joined such demonstrations in the past few years. The only bigger protests were those triggered by China's bloody crackdown in Tiananmen Square in 1989, but those were not directed at the local authorities. Tung Chee-hwa, Hong Kong's unpopular chief executive, as well as his superiors in Beijing, must be feeling very uncomfortable.

The pretext for the demonstration was the Hong Kong government's introduction of new legislation, likely to be adopted by the territory's legislature in the next few days, which critics say will give the administration new powers to suppress those considered subversives by China—of whom the territory has more than a few. But protesters were also motivated by Mr Tung's failure to revive Hong Kong's depressed economy, which was recently dealt another severe blow by SARS. “We're tired, we're angry, step down,” read a sticker sported by many a marcher.

Hong Kong officials have tried to play down the event. Regina Ip, the territory's top official responsible for security, remarked dismissively beforehand that people might join the protest just because it was something to do on a public holiday (Tuesday was the sixth anniversary of Hong Kong's return to China and of Mr Tung's assumption of office).

Still, Mr Tung has good reason to feel uneasy. Even China's prime minister, Wen Jiabao, during a three-day visit to Hong Kong that ended just before the protest began, conspicuously failed to heap comradely praise on the chief executive. With the proposed new security bill having exposed profound mistrust of China in the territory, Mr Wen appeared determined not to aggravate his government's image problem by appearing too close to Mr Tung. Curiously, given the fears expressed by the protesters, Hong Kong's media were full of praise for Mr Wen's carefully cultivated man-of-the-people style (visiting a housing estate where he held the baby of a SARS victim on his lap, for example). One said it hoped Mr Wen could “rub off some of his forward-looking spirit on our reticent leaders”.

There has been no indication that Mr Tung is even thinking of stepping down, nor that China (which effectively gave him the job in 1997) wants him to do so—at least not yet. But the Hong Kong government's decision to push the new security legislation through this month must have been prompted in part by concerns that if left until later, it could have an impact on legislative council elections next year. In these, the number of directly elected seats in the legislature will increase to half, giving Mr Tung's critics a chance of gaining a majority in the hitherto overwhelmingly pro-government council.

David Chu, a Hong Kong legislator as well as a member of China's parliament, says that July 1st's protest signifies the emergence of a “new political force” in Hong Kong. If the government ignores public sentiment, he argues, it risks fuelling a “dramatic” backlash in the form of large-scale protests which in turn could undermine China's image in Taiwan (which China wants to win over by demonstrating that all is well in Hong Kong) and the rest of the world.

Mr Chu's proposed remedy—not favoured by the fiscally cautious administration—is a reflation package that would involve ending the government's austerity measures and removing the currency's peg with the dollar. But the government has not been oblivious to demands for a stimulus. On June 29th, China and Hong Kong signed a deal under which tariffs on many goods exported to the mainland from Hong Kong will be eliminated from next January and service industries from Hong Kong will gain freer access to the Chinese market. Negotiations over the accord were speeded up in order to help revive business confidence after SARS, and also, many observers say, to draw the sting from the security legislation. But the accord is unlikely to have a dramatic impact on Hong Kong's soaring unemployment problem, and the effects will not be evident for several more months.

Mr Tung can at least be confident that China supports his efforts to revamp the territory's security laws. Indeed, without China's prodding he would probably not be bothering with them. China's eagerness could be related to its paranoia about the Falun Gong spiritual movement, though Hong Kong officials insist that neither Falun Gong nor any other registered group in Hong Kong opposed to the Chinese government is likely to fall foul of the new provisions.

If China has worries about Mr Tung's ability to lead, its promotion of this legislation is only making his predicament worse. Hong Kong officials “have really made the people angry,” says Bishop Joseph Zen, the head of Hong Kong's Catholic church, who joined Protestant leaders in support of the protest. He accuses the government of lying about the proposed bill. Bob Allcock, Hong Kong's solicitor-general, rejects such criticisms. He says many safeguards in the law will prevent its being used to curb human rights. As Tuesday's demonstration showed, however, six years of muddled rule have done nothing to instil public trust.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Kashmir

Summer pleasures

Jul 3rd 2003 | SRINAGAR
From The Economist print edition

Not yet peace, but something like it

Get article background

IT ALMOST feels like the old days in Srinagar, the summer capital of the disputed Indian state of Jammu and Kashmir where at least 40,000 people have been killed since an insurgency began 14 years ago. Tourists have returned. Nearly 70,000 have come in the past six months to stay in houseboats on the city's Dal Lake and tour the surrounding mountains, more than double the number in the whole of last year. Troops are slightly less evident in the streets, and the government will soon sanction a mobile-phone service that has been denied for years by security fears. Moderate separatist leaders, as well as mainstream politicians, are talking more positively than before about the need for an end to militancy. People, they say, need to begin to rebuild their lives.

AP

Mehbooba Mufti, president of the People's Democratic Party, which has led the state's coalition government since last October, credits the change partly to a visit in April by Atal Behari Vajpayee, India's prime minister, when he offered a “hand of friendship” to Pakistan. The “jinx was broken,” says Ms Mehbooba. An unprecedented three-day visit to the state last weekend by India's relaxed president, A.P.J. Abdul Kalam (right), also “brought a sense of belonging and security.”

But real peace is a long way off. On the day in June when Mr Kalam visited the border that separates Indian and Pakistani Kashmir, known as the line of control (LoC), 12 Indian soldiers were killed in a suicide attack on an army camp at Sunjwan, near Jammu, 400km (250 miles) to the south. The attack triggered memories of the killing of 34 people, soldiers and members of their families, in May last year, when India and Pakistan came close to war. But militants frequently stage atrocities to coincide with important visits, and the government reacted relatively calmly.

George Fernandes, India's defence minister, claimed that Pakistan's Inter-Services Intelligence agency was responsible for the attack, which Pakistan denied. But Mr Vajpayee's peace moves would continue. Senior Indian army and police officers say that militants continue to cross into Indian Kashmir from Pakistan, but they believe that Pakistan is trying to curb major terrorist attacks. The question for India is what it should do next to bring permanent peace. There is a growing desire among Kashmiris for an end to the killings, but also for some autonomy from India's central government.

The neatest solution would be for Pakistan to accept the LoC, agreed between the two countries in 1972, as the permanent border and for India to restore to Kashmir most of the high degree of regional autonomy that it had for six years after India gained independence in 1947.

But Pakistan says it seeks all of Kashmir, which has a Muslim majority, and India has never seemed

willing to move on the autonomy issue. Many observers believe India would prefer to tolerate unrest, and even terrorism, and keep the LoC as a de facto border, rather than risk a settlement that might give ground to Pakistan and the Kashmiri militants whom it supports.

Significantly, the Pakistan-backed All-Party Hurriyat Conference, a group of 23 Kashmir-based parties with separatist roots, did not greet Mr Kalam with the day-long *hartal* (strike) they usually call when Indian leaders visit. This was seen to reflect growing moderation in a group that is struggling to re-establish its diminished credibility. Abdul Gani Bhat, the Hurriyat's chairman, says that “the noise of politics has taken over from the role of the gun.” Mirwaiz Omar Farooq, a young religious leader and political leader, wants militants to “take a back seat” but “remain a pressure group”.

Privately, some Hurriyat members indicate that they would drop demands for independence or a Pakistan takeover if some form of autonomy were offered by Delhi, perhaps implemented in stages over several years. But they face opposition from hardliners and are assumed to be hobbled by Pakistan, and by the lesson of two leading moderates who have been assassinated in the past 13 months.

The Indian government shuns the Hurriyat, claiming its leaders are unrepresentative, even though they reflect a large body of Kashmiri opinion. It prefers to deal only with the state's mainstream parties, which do not press the autonomy issue aggressively. Mr Bhat will be visiting Delhi later this month with Mr Farooq, seeking a “dialogue that will give real results”, but he seems unlikely to make much progress with the government. He predicted that “within a couple of years we'll be back to normalisation of relations between India and Pakistan,” with “the resolution of the situation in Kashmir”. That shows rare optimism but, as Miss Saeed put it, “people are in a mood for change and, if we don't respond, then we miss the bus. There can't be a better chance than this.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Afghanistan

It's not awful everywhere

Jul 3rd 2003 | BAMIYAN
From The Economist print edition

Life in the hunger belt

THE province of Bamiyan is a rare good-news story for Afghanistan. Few villages on this 2,500 metre (8,000 feet) -high plateau in central Afghanistan have turned to poppy production. Security is not a big issue here. American special forces have disarmed meddlesome villagers. Tensions between the newly arrived Afghan National Army and the local *Hezb-e-Wahdat* militia have amounted to little more than name calling, fist fights, and a few smashed windows. The majority Hazaras—Shias believed to be descended from the armies of Genghis Khan—are loyal to Kabul. For the first time in their history they have a voice in the national political process. Their hero, Karim Khalili, is vice-president.

The Tajik minority driven out by the Hazaras in the 1990s is slowly returning under the UN's auspices. Disputes between Tajiks and Hazaras over trees and water rights are now being settled amicably, despite the warnings of Tajik commanders who told their kin not to go back home. Village elders from both communities say everyone feels safer since the Afghan National Army and a small but visible American military reconstruction team moved into Bamiyan town.

Foreign aid workers find the work ethic of the locals refreshing. “You give a little and they build a lot,” says one admiringly. And indeed, in village after village, the traditional adobe homes razed by the retreating Taliban have been rebuilt, land is coming back under the hoe, and new schools are attended, in some places, by girls as well as boys.

Which is not to say that life in Bamiyan is easy or sustainable. This is the so-called hunger belt, where famished villagers survive by eating grass. The success of the relief effort so far speaks to destitution and an absence of local vested interests. But no one has yet identified a cash crop or cottage industry which might sustain villages after foreign aid has dried up. That raises the spectre of a rise in poppy production and new, narco-enriched commanders. A lack of passable roads—here as elsewhere in Afghanistan—skews the distribution of aid. Seven aid agencies serve 40,000 people in and around Bamiyan town, but only one serves 600,000 people in the hard-to-reach south of the province. The local UN chief, Peter Maxwell, thought he might try getting into the south by horse last winter but was foiled by blizzards. Maternal mortality in the villages he was trying to attend, he reckons, is five times worse than in sub-Saharan Africa.

With its snow-capped mountains, sweeping red hills and sapphire lakes, Bamiyan has the makings of a world-class tourist destination. Its jewel was a cliff formation containing two giant Buddhas—until they were blown up by the Taliban in early 2001. The UN's cultural organisation, UNESCO, is working with Afghan officials to help protect what remains of the Buddhas. That means evicting landless families living in caves at the site to new homes nearby, and deciding whether to piece together the Buddhas from the rubble or to leave them in their current state. Tourists may one day come if security is assured. That may take some time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkmenistan

Time to choose

Jul 3rd 2003 | ALMATY
From The Economist print edition

Ethnic Russians are being driven out

THE peculiar character of Saparmurat Niyazov, the president of Turkmenistan, has often been compared to Stalin's. Until recently, the parallel was most evident in both men's strong penchant for the personality cult—although not even Stalin thought of building a gold statue of himself that rotates with the sun, as Mr Niyazov has in his capital, Ashgabat. But the similarities became still more striking this spring when Turkmenbashi—the leader of all Turkmen, as Mr Niyazov likes to be called—decided to get rid of his country's 100,000 Russians. Unlike Stalin, however, he saved himself the trouble of organising a mass deportation. He has simply made life so miserable for Turkmenistan's ethnic Russians that they have been leaving the country on their own.

In mid-April, Mr Niyazov and Russia's president, Vladimir Putin, signed a big gas deal in Moscow and agreed to revoke a ten-year-old dual-citizenship treaty between the two countries. The Russian authorities had envisioned a gradual phasing out, but the Turkmen leader took them by surprise by issuing a decree that gave dual-citizenship-holders living in Turkmenistan only until June 22nd to decide which passport they wanted to keep. Those who failed to declare a choice would automatically become Turkmen citizens only.

The announcement led to a heated dispute with the authorities in Moscow and panic among the ethnic Russians in Turkmenistan. At home, Mr Putin was accused of betraying Russian nationals by “swapping” them for gas. Russian government officials then began to put pressure on Turkmenistan to rescind the decision. They declared the country unsafe for Russian citizens and openly criticised Mr Niyazov's totalitarian rule. On June 20th, the Russian parliament adopted a resolution condemning the deterioration of Russians' rights in Turkmenistan. They demanded an end to the harassment of those who hold dual citizenship and to the requirement that Russian citizens obtain exit visas to leave the country. Meanwhile, ethnic Russians rushed to sell their apartments for fear of being stripped of their property after the deadline, since only Turkmen citizens are allowed to own real estate. Predictably, property prices have plunged.

How strictly the citizenship decree is now being enforced is not yet clear. There are reports that some Russian citizens are being evicted from their homes. By Stalin's standards, they may be getting off lightly. But that is not saying very much.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Indonesia

Getting away with murder

Jul 3rd 2003 | JAKARTA
From The Economist print edition

Indonesia's army chiefs are still untouchable

THE most senior Indonesian military officer indicted by Jakarta's special tribunal for the violence in East Timor in 1999, Major-General Adam Damiri, made a heartfelt plea this week for mercy from the five judges trying his case. The verdict is to be announced on August 5th. But the former commander of the region overseeing the territory at the time is unlikely to have many sleepless nights. Prosecutors, citing lack of evidence, have recommended that all charges be dropped.

Only two Indonesian military officers have been convicted over the violence, in which hundreds died, and they are free on appeal. Amnesty International, a human-rights group, has described the trials as neither honest nor fair. Meanwhile the UN-established Serious Crimes Unit in East Timor has indicted 63 members of the Indonesian armed forces, including the then commander, General Wiranto, as well as General Damiri, for crimes against humanity. All are safe in Indonesia and, as long as they stay there, are almost certain to escape prosecution.

Reuters

No vengeance for Timor

Such impunity is not confined to East Timor. In April seven special-forces soldiers were convicted of causing the death of the pro-independence Papuan politician Theys Eluay in November 2001. But no attempt was sought to ascertain ultimate accountability. Few analysts believe the senior officer on trial, a lieutenant-colonel, could have initiated such a controversial operation.

Also this week, the first trials began over what is known as the July 27th incident, the storming (in 1996) of the party headquarters of Megawati Sukarnoputri, then an opposition leader, but now president, in which dozens of people are thought to have died. The most senior person on trial is a retired colonel. The military commander of Jakarta at the time, who now happens to be the capital's governor and a staunch Megawati supporter, is conspicuous by his absence.

In the next few weeks the trials are expected to begin of 14 soldiers for the violent suppression of a demonstration at Jakarta's Tanjung Priok port in 1984 in which hundreds are suspected to have been killed. Again, the then Jakarta and national military commanders are not among the indicted. Rampant human-rights abuses are also alleged in the armed forces' current operation to crush separatists in Aceh: but no soldiers have yet been charged over the deaths of some 200 civilians.

How and why are the generals getting away with these and many other alleged abuses? Under President Suharto and his successor, B.J. Habibie, they were untouchable. President Abdurrahman Wahid, who followed, wanted to weaken the armed forces before targeting individuals, but did not survive long enough. Ever since they played a key role in elevating her to the presidency in July 2001, Miss Megawati has felt indebted to the generals.

This has become increasingly obvious in recent months, as they have started to recover their power. A government consultative paper published earlier this year argues for the army to regain some of the domestic responsibilities lost to the police in the wake of the fall of Suharto in 1998. Part of this is to be achieved by the scrapping of plans to abolish the military's “territorial” function, which allows for a presence down to the village level.

Meanwhile, a new bill includes a clause that allows the armed forces to act for 24 hours without presidential consent. The generals have also seen off plans to audit the army's business activities, which provide an estimated 70% of the defence budget. These two developments have, for the most part, gone unchallenged by politicians, most of whom, with an eye to next year's general election, think the army is the only way to deal with the Islamist and separatist threats.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Laos

An angry dinosaur

Jul 3rd 2003 | BANGKOK
From The Economist print edition

Foreign journalists jailed after investigating anti-communist rebels

SLEEPY Laos rarely makes the news. Its secretive communist government prefers it that way. But when two foreign journalists were caught investigating a long-forgotten conflict, they were put on trial accused of possessing weapons, obstructing security forces and being involved in an incident that resulted in the death of a village guard. This week, a court sentenced Thierry Falise, a Belgian freelance reporter, and Vincent Reynaud, a French cameraman, to 15 years in jail. Their interpreter, Naw Karl Mua, an American of Laotian origin, received a similar sentence. Diplomats had hoped for a quiet expulsion. Instead a noisy row has begun over Laotian justice.

The defence lawyer learnt of the charges only when they were read out in court. Media groups say the trial was a sham designed to deter reporters from probing Laotian affairs. What riled the authorities was the journalists' interest in a dwindling band of Hmong rebels recruited by the CIA in the 1960s to fight communism. Incredibly, some are still fighting, three decades after the Vietnam war ended. After the 1975 communist victory, hundreds of thousands of Hmong fled to France and America. The rest were mostly brought under the control of the government. Yet small groups of armed Hmong still roam the jungles.

On June 3rd, Mr Falise and Mr Reynaud were returning from a Hmong base when their escorts ran into a security patrol. As gunfire broke out, the journalists fled. A village guard was later reported dead. Next morning, the journalists and their interpreter were arrested and transferred to a jail in the capital, Vientiane.

The two Europeans were not the first to rake the coals. A *Time* magazine story on the rebels in April had infuriated the government, which calls them bandits and blames them for recent bus bombings. Laos is sensitive to accusations by Hmong exiles that the Hmong are being persecuted for their wartime role. Proof of lingering ethnic strife in Laos undercuts the government's claim that the country is unified.

Laos may be a prickly dinosaur, but its budget is mostly foreign aid. It is also trying to close a trade deal with America. That makes a quick release of the detainees desirable, but not inevitable, though one Laotian embassy said they could be free within days. An Australian couple jailed for gem smuggling in Laos in 2001 spent ten months inside before diplomacy worked its magic.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Post-war Iraq

Walking on eggshells

Jul 3rd 2003 | BAGHDAD
From The Economist print edition

AFP

The occupiers face growing Iraqi impatience, but soldier on

Get article background

UNDER Jaderiya Bridge in southern Baghdad, American soldiers are searching cars and frisking civilians. It is a dark riverside known for drunks and guns. Three Iraqis approach an American sergeant, one hobbling on crutches. The eldest tells him that an American tank shell killed his baby daughter four hours before the first Saddam Hussein statue fell in Baghdad. The second waves to a leg peppered with shrapnel, caused, he says, by American gunfire. The third just scowls. All demand restitution: the sergeant shuns responsibility. It is the usual, bitter dance of an unaccountable occupying force and an unrepresented people. “It sucks,” says the sergeant. “You promise freedom. They get martial law.”

Ten weeks after Baghdad's liberation, coalition forces are facing a swell of Iraqi attacks. Last week, two American soldiers were kidnapped and found dead. On July 1st, a rocket-propelled grenade killed one more and on July 3rd, seven Americans were wounded and one passer-by killed in two separate explosions. Since George Bush declared an end to major combat operations on May 1st, some 30 coalition soldiers have been killed by Iraqi fire.

The Pentagon has dismissed the losses as militarily insignificant, and this week Mr Bush spoke toughly of his determination to stay the course. “The rise of Iraq, as an example of moderation and democracy and prosperity, is a massive and long-term undertaking,” he said, promising that America would use “direct and decisive force” against attackers. Meanwhile, America is reported to be considering dispatching more troops, and Britain says that seven countries have offered to send forces to bolster its 11,000-man contingent. Britain's foreign secretary, Jack Straw, flew into Iraq on July 2nd to assess the situation.

Officials in Washington blame the attacks on a mix of criminals, Iranian agents and Baathist saboteurs. American spokesmen on the ground are less categorical. They say some insurgents are Iraqis angry over the loss of their country and “ignorant about the good things we do”. But the response is the same: massive arrest campaigns that are supposed to net members of the Baath Party but dredge hundreds of innocents. Equally galling for the locals, the soldiers who conduct these sweeps sometimes show little respect for Iraqi customs or for due process.

Iraqis accept that some attacks may be part of a revanchist plot. Others have less complicated causes. In

April in Faluja, a hot, torrid, town west of Baghdad, American soldiers shot dead 15 Iraqis protesting outside a school. Since then, a deadly ritual has set in between vengeful Iraqi attacks, retaliatory searches and mutual recrimination. When a blast killed nine Iraqis in a Faluja mosque on July 1st, locals scoffed at American claims that a bomb-making class was being held. Instead, they insisted that the Americans had fired a missile. The next day hundreds marched calling for *jihad*. It will come, says Ahmed Janabi, a Sunni cleric. “Faluja is a tribal town. When one is killed, members of the tribe have to exact revenge. They have nothing to do with Saddam.”

The idea of resistance finds growing support among a people outraged by their occupiers' failure to fix some of the most basic problems. Baghdad recently went four days without electricity, a harsh deprivation in searing temperatures of 50 degrees. American soldiers said the loss was caused by sabotage. “Look, if you blow up a power station it means you don't get power,” explains a captain. But Baghdadis murmur that this feels more like collective punishment, doled out by a superpower angered by their failure to co-operate.

Baghdad is a city in thrall to fear and violent crime, with increases in armed robbery, carjackings and the rape and abduction of women. The city coroner reports that murders are running at 15 a day, more than the monthly toll before the war, if one excludes those killed by the regime. The few Iraqi policemen on the streets complain that they are sent to the wrong places or are given pistols without bullets in neighbourhoods armed to the teeth. Dusk empties the streets long before curfew. Into the twilight step American soldiers, policing drunks under bridges. Few Iraqis want the old regime to return; even fewer feel free. None feels safe.

“Freedom would be the best thing,” says Taha Bawdawi, mayor of Faluja. An exile under Saddam and chosen by the town's main tribes, he is described as a decent man by occupier and native alike. He accepts that the United States must protect its soldiers against armed attacks. But he says this should not happen at the expense of providing basic social services for the Iraqi people or by flouting their dignity. Above all, he says, the Americans must swiftly and visibly arrange elections so that a legitimate Iraqi government can be formed and the liberators can go home.

An echoing, but far more potent expression of this view has now come from Iraq's most senior Shia cleric. Dramatically ending months of aloofness from politics, Ayatollah Sistani this week issued a *fatwa* rejecting as “unacceptable” coalition plans to appoint an advisory council of Iraqis, and to give another, broadly representative body the task of drafting a constitution. Instead, he said, elections should be held immediately to choose delegates to a constitutional convention. This should be followed by a referendum to approve the constitution. The message was clear. Iraq's 60% Shia majority do not intend to sit idle if America plans to devise a way of diluting their influence. Nor will the Shia clergy miss a chance to widen the role of religion in the state.

Having alienated many Sunnis, the coalition cannot afford to provoke the Shias as well. Perhaps this is why Paul Bremer, the American ruler of Iraq, this week reversed a previous decision and authorised the holding of local elections across the country. American forces also arrested the governor of Najaf, a man they installed in April. As a Sunni in this overwhelmingly Shia region, a former colonel in Saddam's army and a suspected swindler to boot, he was an odd choice to begin with.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Israel and the Palestinians

One step at a time

Jul 3rd 2003 | JERUSALEM
From The Economist print edition

With a fragile truce, both sides embark on the difficult road to peace

Get article background

A TENUOUS ceasefire agreement and a few days of relative quiet have provided war-weary Israelis and Palestinians with a glimmer of hope. Ariel Sharon and Mahmoud Abbas, the Israeli and Palestinian prime ministers, made a carefully choreographed public appearance together in Jerusalem on July 1st to cement the fragile détente. But it could yet crumble over Israeli and American demands that Mr Abbas disarm militant factions, or over Palestinian demands that Mr Sharon release thousands of prisoners. New acts of violence, too, could destroy the hesitant quest to bring 33 months of conflict to a halt.

EPA

Friends, maybe

The agreement between Israel and the Palestinian Authority (PA) came as Condoleezza Rice, President George Bush's national security adviser, shuttled to and fro to ensure a successful end to weeks of American diplomacy.

As a first stage, the PA was to resume “security responsibility” for the Gaza strip. Before that went into effect, the two radical Islamist factions, Hamas and Islamic Jihad, jointly announced on June 29th an ostensibly unrelated “suspension of the military operations against the Zionist enemy for three months” in the interests, they explained, of Palestinian unity.

This was the elusive *hudna*, or truce, that Egypt had been toiling for months to achieve. Fatah, the largest Palestinian political movement, followed a few hours later with a ceasefire declaration of its own. That night, Israeli tanks and trucks rumbled out of Beit Hanoun, the northernmost town in the Gaza strip. The next morning, Palestinian police took up positions along the north-south highway and traffic began flowing unfettered through Gaza for the first time in years.

Free of Israeli roadblocks, Palestinian drivers whooped for joy. Israeli troops remained deployed around the Jewish settlements. There was sporadic shooting at the settlements that night. But on the following day, July 2nd, the Israeli army reported complete quiet throughout the Gaza strip.

On the same day, the PA also took back control of Bethlehem, the first of the major towns on the West Bank which the Israelis are supposed to return to it. Israeli tanks are still visible outside of Bethlehem, but there are to be no more incursions into the town itself, the army says, provided things stay quiet.

The ceasefire was marred by the killing of a foreign driver on a West Bank road near Jenin on June 30th. A local cell of the al-Aqsa Martyrs Brigade, a secular radical group attached to Fatah, took responsibility. On July 1st, soldiers killed a young Palestinian near Tulkarm, whom they accused of attacking them with a pistol. Two days later, another young Palestinian was shot dead, and another wounded and arrested by Israeli forces. Israeli officials attributed all three incidents to the al-Aqsa Martyrs. They said this group was less centralised and less disciplined than the Islamist militants, with some of its cells taking orders from Hizbullah in Lebanon or even from Iran.

The Palestinian Authority will have to find a way to rein in the al-Aqsa Martyrs before they contrive a bombing that could wreck the ceasefire. More daunting still is the challenge to Mr Abbas posed by the Islamists. The head of the Israel's Shin Bet security service, Avi Dichter, insists there will be no further Israeli withdrawals unless the PA begins to disarm Hamas and Islamic Jihad. He gives Mr Abbas three or four weeks to embark on this dangerous task and warns that to shirk it would be to risk not only the ceasefire but the entire basis of the PA as a state-in-the-making.

President Bush, too, in a speech last week, called for the dismantling of the Islamist terror organisations. Colin Powell, America's secretary of state, pressed the same point in a series of television interviews on July 1st. “Ceasefires alone won't be enough,” he said. “We ultimately have to reach a point where the capability for terrorism that exists in these organisations is removed.”

The Middle East “road map”, the three-phase peace blueprint to which both sides are committed, requires the “dismantlement of terrorist capabilities and infrastructure”, including “commencing confiscation of illegal weapons” as part of its first phase.

And yet Mr Abbas and his security chief, Muhammad Dahlan, clearly would prefer to avoid a direct confrontation with Hamas and Islamic Jihad. Palestinian observers cite the *hudna* as evidence that pragmatic accommodation with the hard-liners is possible despite their uncompromising ideology. Mr Abbas rehearses his commitment to creating a single armed authority in the Palestinian territories. He believes that with time the Islamists can be brought to focus on their political and philanthropic activities and to put their guns aside without a fight. But the Israelis and the Americans remain sceptical.

For Mr Abbas, the next critical issue is the release of Palestinian prisoners held in Israeli jails. Mobbed by relatives of prisoners in Gaza last week, he pledged that the peace process would result in all of the more than 6,000 prisoners being freed. Mr Sharon, at their meeting on July 1st, said that he had seen this scene on television and could sympathise with Mr Abbas's political problem. But Mr Sharon would not release murderers. He had asked Shin Bet to draw up lists of lesser offenders. He suggested that the two leaders meet again next week to discuss the issue further.

Mr Sharon was less sympathetic when Mr Abbas raised the matter of Yasser Arafat's continued incarceration at his headquarters in the West Bank town of Ramallah. Mr Arafat was free to go to Gaza, Mr Sharon said. Provided he did not return to the West Bank.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Vote-buying in Kuwait

Making cheats accountable

Jul 3rd 2003 | CAIRO
From The Economist print edition

With the help of a mobile phone

PAYING for votes is as old as the ballot box, but so is the problem of guaranteeing delivery. Technology may be the solution. Clever candidates in Kuwait are rumoured to be planning to hand willing voters digital “spy” cameras that look like pens or mobile phones. All it takes to prove they have ticked the right name on the ballot is a discreet click. With cellphone, they can send a picture message as proof, as soon they leave the polling booth.

The system, say Kuwaitis, is likely to be put to the test when the oil-rich emirate votes for a new parliament this week. Which is to say, when the 140,000 men who are allowed to vote, out of the emirate's 900,000 citizens and 2.3m residents, cast their ballots. Not surprisingly, the small size of this pool affects the price of votes. In the more hard-fought of Kuwait's 25 constituencies, such as wealthy districts of Kuwait City that have fewer than 2,000 registered voters, bids are said to have reached $5,000 per vote. Candidates in tribal areas may get off more lightly. In the past, wholesale dealers claim to have delivered entire clans for a fraction of the cost per head.

In anticipation of such antics, Sunni and Shia religious leaders have issued severe *fatwas* forbidding vote-trading. The government has also said that the polls will be strictly monitored. Opposition candidates, however, claim that the state itself has slipped subsidies to the candidates it favours—quite useful considering that some campaigns, which typically include the erection of air-conditioned tents offering free meals, are costing tens of thousands of dollars a day.

Similar allegations have marred previous elections during Kuwait's four decades of semi-democracy. But with the fear of an Iraqi attack now lifted, calls for reforms—such as an end to gerrymandering, and to the tradition by which the crown prince always serves as prime minister—have grown louder. Liberals are even demanding votes for women, but in a recent poll, 57% of candidates rejected that idea.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Computer studies in Congo

Light in the Harvard of darkness

Jul 3rd 2003 | KINSHASA
From The Economist print edition

Against the odds, Congolese students are learning about IT

Get article background

DOZENS of students stand at a bend in the road, waiting to hijack a truck. They have picked a good spot for it. An enormous pothole cuts the road in two, forcing vehicles to slow almost to a stop. The students then pile on and force the driver to take them, for free, to their university, some 15km (nine miles) away on the outskirts of Kinshasa, Congo's squalid capital. Every week or so a driver dares say no, and gets a beating or his truck smashed up.

Other, better behaved (and female) students prefer to stay on campus, sleeping in classrooms to save money, and to be sure of getting a desk when lectures start in the morning. There are some 15,000 students at the University of Kinshasa, and though they might be from the nation's better-off families, few can afford the daily minibus fare of 300 Congolese Francs (about $0.75).

Student life in Kinshasa is not for the faint-hearted. Few institutions in Congo have escaped the country's steady slide into ruin, and the university, built by its Belgian founders to be central Africa's biggest and best, is no exception. The science faculty's library, for example, now houses fewer than 300 books. The volunteers who work there complain that all are out of date and half are in languages no one speaks. Degree courses are supposed to last five years, but strikes by unpaid teaching staff and riots by angry students mean the academic year often runs late, sometimes a whole year late.

For most students, however, the effort is worth it. If you want a job and daddy is not a minister, you need skills. In one small classroom, a handful of students are bent over computer screens, eagerly learning to build and operate local computer networks and link them to the internet. The course is sponsored by the United Nations and Cisco, an American software firm. Technology makes up, at least partly, for the shortage of books and teachers. Students at the “Cisco Academy” do not use books at all. Instead, all learning is done online. Tests are sent off to markers a continent away at the touch of a button—when the electricity is working.

When the students graduate, they find their skills in demand. Although (or perhaps because) the country's postal and fixed-line telephone services have long since atrophied, mobile telephones and email are booming, and the firms that supply them need IT-savvy recruits. Kinshasa University's e-learners are excited about their prospects, but realistic. Etiennette Mukwanga says she is proud to be learning something useful, despite all the hardships. Her ambition? The same as all the other students: “To become someone who can support her father, mother, brothers and sisters.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Italy and the European Union

Turbulence for Silvio Berlusconi, at home and abroad

Jul 3rd 2003 | BRUSSELS AND ROME
From The Economist print edition

EPA

Silvio Berlusconi makes an absurd start to Italy's presidency of the European Union

Get article background

EVEN before Silvio Berlusconi, the Italian prime minister, rose to speak to the European Parliament on July 2nd he was getting an unprecedented battering in the European press. Italy will hold the European Union's presidency for the next six months and Mr Berlusconi will therefore, formally speaking, be the EU's leader.

This prospect had already been greeted with a wave of unflattering comment. The *Berliner Zeitung* called him a “shady deal-maker” and “a man whose hand we would not shake voluntarily”. France's *Libération* called him a “threat to liberal democracy”. In Denmark, *Information* claimed that “Italy today is a country in which nepotism, corruption and dishonesty are incarnate in the political leader,” while the *Times* in Britain suggested that modern Italy might fail to meet the criteria for joining the EU because of question-marks over the independence of its judiciary and press.

To make matters worse for the prime minister, the international press's low opinion was played back to Italians by their own *Corriere della Sera*, generally considered right-of-centre, which devoted its main front-page story and two entire inside pages to the international lambasting of Mr Berlusconi.

Under the circumstances, what was called for was a measured and reassuring performance in his first set-piece appearance as the EU's president. Instead, speaking before the European Parliament on July 2nd, he committed a terrible gaffe. Clearly rattled by criticism of him by socialist and Green MEPs for his legal problems and conflicts of business interests, the Italian prime minister lashed out. He remarked that a film on Nazi concentration camps was currently being made in Italy and suggested that Martin Schulz, a German MEP and a vice-president of the European Parliament's socialist group, would be perfect for the part of camp *capo* (commandant in Italian, mere guard—*Kapo*—in German).

Invited to withdraw his remarks by Pat Cox, the parliament's speaker, Mr Berlusconi refused, saying that his comments had been an ironic reference to Mr Schulz's tone of voice and hand gestures. Perhaps, he

suggested, the irony had been lost in translation. To compound the wretched impression he was making, Mr Berlusconi also made a series of rambling, jocular remarks about the delights of Italy as a tourist destination and the excellence of Italian television. His audience was stunned.

The Germans, unsurprisingly, were appalled. The next day their chancellor, Gerhard Schröder, was roundly applauded in the Bundestag, his country's lower house of parliament, when he demanded a public apology from his Italian counterpart.

All hugely embarrassing, but does it matter? Most of the EU's real business is managed by the Brussels bureaucracy. Holding the presidency for six months lets a country and its leader host a few summits, chair a lot of meetings and enjoy an unusual share of the international spotlight. But it is rare that six-month presidencies decisively affect the Union's direction.

That said, a truly erratic presidency of the sort that Mr Berlusconi promises to deliver could still do some real damage. The council's president can play an important part as honest broker, helping to shape the complex legal and political compromises often needed to win consensus. So the presidency must sometimes take a more neutral position than it would like.

The Hellenic example

Over the past six months, for example, the Greeks would probably have sided with the anti-war camp in Europe over Iraq, had they not been constrained in their role as EU president to be scrupulously neutral. It is doubtful that Mr Berlusconi has the tact and restraint to play so self-effacing a role, which could be sorely required if bitter controversies emerge at the two biggest European summits where Mr Berlusconi will have to chair the meetings himself.

The other key ingredient for a successful presidency is a close working relationship with the European Commission. But this too may be hard, since the commission's president is Romano Prodi, a fellow Italian and long-time foe of Mr Berlusconi, who says he will call him every day. But the two men despise one another. More to the point, each has a reason for undermining the other. Mr Prodi, who beat Mr Berlusconi in a general election seven years ago, could well return to Italy in 2004 to lead the opposition into the next one.

In any event, the shadow of domestic politics will hang heavy over the Italian presidency. At 9.30am on June 30th, thanks to an immunity law passed by a parliament in which he has a majority, Mr Berlusconi's trial on charges of having bribed a judge was suspended indefinitely. At midnight that same day, Italy took over the presidency. Even by Italian standards, it was a close run thing. Mr Berlusconi's hope was that Italy's presidential tenure would give him a chance to shine internationally and relegate his domestic tribulations to the background.

But so far it has done the opposite, drawing attention as never before to the Italian prime minister's idiosyncratic relationship with the courts and the media. As Italy's richest man and easily its biggest media magnate, Mr Berlusconi can influence over 90% of what Italians see on television. Infuriated by the most frequent accusation—that he got the immunity law passed to keep himself out of jail—Mr Berlusconi has been hitting back. But he did so in a way that merely gave more ammunition to the critics questioning his suitability for guiding the EU. Italy's real problem, he said on radio, was not his conflicts of interest but the “cancer” of a politicised judiciary. He himself had been against the immunity law but the idea for it had been backed, he said, by Italy's President Carlo Azeglio Ciampi.

Wittingly or not, the head of government had accused the head of state of exceeding his powers by interfering with the legislature. His spokesman later issued a retraction. In the same interview, Mr Berlusconi also succeeded in depriving himself of succour from the left-wing opposition. Its leaders had said they would pull their punches in the national interest during Italy's presidency. But Mr Berlusconi's claim that the left was inextricably tied to judges levelling false charges put an end to that. In any event, the prime minister's legal difficulties are not necessarily over. The immunity law has been referred by the judge in his case to the Constitutional Court. A petition is being got up to try to overturn it in a referendum. And his co-defendants in the same trial will anyway be back in court at the end of September.

Rarely can a presidency of the European Union have started more tempestuously. During his ill-starred speech to the European Parliament, Mr Berlusconi mockingly reassured his critics that the presidency is only for six months and would soon be over. It was one of his few remarks to gain sustained applause.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The German and French economies

Co-ordinated kick-start?

Jul 3rd 2003 | BERLIN AND PARIS
From The Economist print edition

The French and German governments are looking at similar ways to revive their economies

Get article background

LOW growth, high dudgeon: the euro zone's economies are sputtering to a halt. Germany grew at 0.2% last year, the Netherlands at 0.3%, Italy at 0.4%. France managed only 1.2%. Of the bigger economies only Britain (1.8%) and Spain (2%) posted barely adequate results. Since France and Germany account for just over half the euro area's GDP, all eyes are now on their governments' attempts to bring about a revival. And though the two countries may not share the same malaise, they are starting to share, and even co-ordinate, a hoped-for remedy.

The biggest worry is still Germany. Its government this week approved the plans of the finance minister, Hans Eichel, to lop *euro*22 billion ($26 billion) off income taxes from January. Chancellor Gerhard Schröder hopes that the cuts, which should prune the average worker's tax bill by 10%, will help to fizz up the economy. But they will also cut public revenue, increasing the risk that Germany will breach the EU's stability pact for the third year in a row in 2004, making it liable to billions of euros in sanctions. No wonder that Mr Schröder and his ministers have been dropping loud hints about their desire to see the pact interpreted more flexibly.

Germany has had the lowest growth in the EU for the past three years—well under 1% on average. Having shrunk in the final quarter of 2002 and again in the first quarter of this year, it is technically in recession. The German Institute for Economic Research in Berlin, one of the country's six leading economic think-tanks, predicts negative growth (of -0.1%) this year.

The government claims it can pep up growth without busting its budget. Few believe it. Germany ran up a public deficit of 3.6% last year, well beyond the EU's 3% limit, and is heading for a bigger one this year. In presenting next year's budget, Mr Eichel solemnly insisted last week that Germany would stay under the EU's 3% mark. But his calculations are based on an assumption of 2% growth next year, compared with the 1.4% forecast by most independent economists. Moreover, they ignore the government's decision to bring forward the *euro*15.4 billion of tax cuts originally due in 2005 and combine them with the *euro*7 billion of cuts due next January 1st.

Mr Eichel has plans to make savings and cuts in government spending of *euro*14 billion next year. But these were designed to offset the expected shortfall in revenue in 2004—before the extra tax cuts were announced. So new savings will have to be found, and they will all have to be approved by the Bundesrat, the opposition-controlled upper house, which rejected similar measures earlier this year. This time, however, conservative leaders sound readier to back the government.

Most Germans have welcomed the plan to bring forward the final stage of the tax reforms, passed in 2000, under which the top rate of income tax will fall to 42% and the bottom rate to 15%. But most economists expect its effect on growth to be modest. Few believe it will be enough to push Europe's biggest economy out of its doldrums. They fear that the hoped-for boost in consumer spending will be cancelled out by Mr Eichel's cuts in subsidies and tax breaks. Mr Schröder's plans for labour-market and welfare reform may help growth, but probably not before 2005.

And on the other side of Rhine

France is also cutting taxes, regardless of the effect on the budget deficit. President Jacques Chirac has now confirmed that he will press ahead with the 30% cut in income taxes that he promised in last year's

election campaign. “Income tax has been reduced by close to 7%”, he said last week, “and this reduction will continue.”

It is, in part, a response to a weakening economy. The government has already pared down its forecast forgrowth in 2003 from 2.5% to 1.3%. But many economists, including those at INSEE, the official statistics institute, reckon the real figure will be closer to 0.8%. Household confidence is flat and business confidence dipped in May, during prolonged strikes against pension reform. Unemployment, now 9.3%, is climbing. Exports, hit by the strengthening euro and recession in Germany, France's biggest trade partner, are dipping too.

Still, France's economy is holding up better than Germany's, as it has done ever since 1995. Unlike Germany, France faces no current risk of deflation. And growth in French consumer spending, which has been propping up the economy, has been slow but steady, though it fell in May. If the government's cuts to taxes and other payroll charges work as planned, France could help to revive the entire euro area.

The biggest obstacle could turn out to be the European Commission, which has threatened to fine both France and Germany for flouting the stability pact. Yet such threats ring increasingly hollow. The argument that the need for a looser fiscal policy to stimulate demand outweighs the need to control budget deficits is persuasive in both countries. Francis Mer, the finance minister, sniffily refused requests last year to trim France's swelling deficit, which reached 3.1% in 2002. Alain Lambert, the budget minister, simply declared last week that the budget deficit this year would grow to around 3.5%. The tactic of Jean-Pierre Raffarin, the French prime minister, seems to be to push ahead first with tax cuts, with a view to using the deficit as a tool to enforce public-spending cuts later. The French, after all, rather like using constraints supposedly imposed by the European Commission as a means of carrying out unpopular domestic reform.

It may be a coincidence that Messrs Schröder and Raffarin, leading centre-left and centre-right governments respectively, are adopting a similar approach to reviving their economy. Or is it the start of a more co-ordinated common stand?

Officially, no. But the two governments have recently been working closely on other matters, from Iraq to farm reform. “There's a clear sense that France and Germany are moving side by side on economic co-ordination,” says a French official. If so, no need to worry too much about penalties for breaching the stability pact. “Since last week, a clear Franco-German strategy has emerged: to pursue structural reforms and cut deficits only after, when growth resumes,” says Jacques Delpla of Barclays Capital in Paris. “This entails each voting no to fines against the other.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

French wine

Superleague bouquet

Jul 3rd 2003 | PARIS
From The Economist print edition

A furious reclassification of French wine

LAST week, for the first time since 1932, France reclassified its *crus bourgeois* wines. This class of bordeaux, which ranks below the superleague of the *grands crus classés*, ranked in 1855, had escaped the codifying hand of the state for decades. Now, just nine wines have made it into a premier division of *crus bourgeois exceptionnels*, including Château Chasse-Spleen and Château Potensac; 87 go into a second league of *crus bourgeois supérieurs*; and 151 have qualified as simply *crus bourgeois*. No fewer than 243 wines, to the fury of their producers, have been thrown out.

Ostensibly, these changes are about fairness. Plenty of good wines have emerged since the last classification but had gone unrecognised—and unrewarded by the price increase that may follow an official seal of approval. At the same time, poor-quality wines had been passing themselves off as the real thing. “Lots of growers have been putting the *crus bourgeois* label on their wines and getting away with it,” says one *négociant* in Bordeaux. Now, the cheats have been evicted, the genuine article honoured.

The new classification will also help lift the bordeaux brand itself, which was at risk of becoming devalued by the unchecked proliferation of the *crus bourgeois* label. It took a jury of 18 fine noses, including members of the Oenology School of Bordeaux, 18 months to taste, test and adjudicate. Ambiguity does not sit easily with officialdom in France. Now everybody knows what is judged good, and what not.

Perhaps, though, there is another motive for the new ranking, less to do with grand notions of purity and more to do with crude commerce. Exports of French wines have been battered by the continuing popularity of “new world” wines, the global economic downturn and, more recently, the strengthening euro and souring consumer sentiment in America towards France. In the 12 weeks to the end of May this year, French wine sales to America dropped by 24%, compared with the same period in 2002.

The *crus bourgeois*, in particular, have been caught awkwardly in the market between the posh, expensive *grands crus classés* and everyday plonk. Many were undervalued, and found it difficult to compete with the rival Australian or Spanish mid-priced wines. “Now, the words *cru bourgeois* mean something very clear, and have been given a certain quality,” says Dominique Hessel, head of the Association of the Crus Bourgeois of Médoc. Endowing the *crus bourgeois* with a new sense of prestige could prove an astute marketing ploy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Spain and the Basques

Dangerous stalemate

Jul 3rd 2003 | MADRID
From The Economist print edition

Violent and non-violent Basque nationalists are both raising the ante

THERE are three competing visions of the future for Spain's troubled Basque region. The mainstream parties in Madrid— the ruling conservatives of the People's Party (PP) and the opposition Socialists—both broadly support the status quo: wide autonomy for the Basques but definitely as part of Spain. At the other end of the scale, the Basque nationalists who sympathise with the terror group ETA and its political voice, Batasuna, want complete independence for the Basque region (plus a hunk of Navarre and of south-western France, to boot), to be achieved by violence if need be.

In between, the non-violent Basque Nationalist Party (PNV) wants something close to independence but with some kind of link to Spain; it equivocates over the precise nature of the Basque-Spanish relationship and, in the PP's view, wobbles infuriatingly in its attitude to terror while itself eschewing it. In local elections in May, the PNV easily won once again. Plainly, there is no sign that it is losing its grip on region.

José María Aznar's government in Madrid finds that intensely frustrating, particularly because he thinks the PNV is cynically opportunistic in refusing to endorse his more robust approach (which the PNV considers unsubtle and self-defeating) to terrorism. Yet Mr Aznar cannot find a way to get the majority of Basques—peace-minded or not—on his side, to bring long-term peace and stability to the region.

This week Juan José Ibarretxe, the PNV man who heads the Basques' regional assembly, again called on Mr Aznar to hold talks with all Basque nationalists, while gloomily warning that “we may arrive too late, as communication has been made impossible, and Spain and Euskadi [the Basque region] may be unable to live together.” Meanwhile, the PNV's senior member of the national parliament in Madrid, Iñaki Anasagasti, accused Mr Aznar of “excluding” the Basque region and seeking to “throw us out of Spain”.

Putting your Basques in one exit

The PP, with a brave face, says it has scored a victory by having Batasuna, ETA's political wing, banned from electoral politics, so striking a blow against terror. Rubbish, says Batasuna: some 150,000-odd voters (10% of those who went to the recent polls) shoved in their own special ballot papers to protest against Batasuna's exclusion.

But the PNV's vote rose to 41%, from 35% in 1999, when local elections were last held, against 18% for the PP (a tad down from last time) and 20% (a tad up) for the Socialists. The PNV also tightened its grip on Bilbao, the Basques' commercial capital, and even managed to match the PP in Vitoria, the Basques' regional capital, where loyalty to Spain is usually strongest. Mr Ibarretxe said his party's gains would strengthen its case, deemed controversial in Madrid, for holding a referendum on whether the Basque region should become “a free state associated with Spain”.

The latest bone of contention is a stand-off between the PNV and the Supreme Court in Madrid, which has been egged on by the PP. After the PNV's election victory, Mr Ibarretxe's government challenged the national one in Madrid by defying the Supreme Court's order to dissolve Batasuna's seven-member group (cheekily renamed) in the regional assembly.

Spain's deputy prime minister, Mariano Rajoy, accused the PNV of creating “a most serious institutional conflict, unprecedented since the constitution was adopted [in 1978]”. Spain's justice minister, José María Michavila, promised to start criminal proceedings “so that those who seek to collaborate with terrorists must answer before the law.” Spain, he said, would “expel ETA from its democratic

institutions—despite the PNV”.

Meanwhile, Juan María Atutxa, the Basque assembly's speaker, is sitting tight. He still refuses to eject the assembly's ETA proxies. The Supreme Court's judges are pondering how to punish him. Some predict he will be fined; others say he will be suspended from his post. Mr Aznar's government has ruled out dissolving the assembly, while the PNV blithely declares that opposing the court is nothing special. Commentators across the political spectrum in Madrid say that the PNV has entered dangerously uncharted waters.

For sure, Batasuna has lost legislative power, thanks to the ban against it. Before the elections, it controlled 43 of the region's 250 town halls. The PNV is in the odd position of benefiting from the ban, insofar as it has gained a lot more council seats and mayoral offices, while refusing to oust Batasuna people (under whatever name) from the assembly. Hypocrisy, says the PP, complaining that the PNV is playing cheap politics while putting Spain's territorial integrity at risk.

Whether or not its proxies can take their seats in the assembly, ETA is still able and willing to kill. At the end of May it ended a three-month lull by killing two policemen in Navarre. Three weeks ago, it left a huge bomb (later defused) in a car in Bilbao. Last week it blasted a hotel near Bilbao (without killing anyone). This week a car bomb, again in Bilbao, was defused by police. No end to the strife, violent or political, is yet in sight. And Mr Aznar is no closer to finding a solution.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Portugal's public sector

I'm going to gut it

Jul 3rd 2003
From The Economist print edition

Portugal's prime minister is planning a drastic but timely pruning

AFP

The axeman cometh

THE position is for life. Dismissal is against the law. Promotion is automatic. The pay is above average; regular increases are guaranteed. Performance is always marked ten out of ten.

A comfortable job for some particularly lucky soul? Not exactly. More than 708,000 Portuguese public-sector workers, 15% of the national workforce, are employed under these enviable terms. But José Manuel Durão Barroso, the centre-right prime minister, plans radical changes in the job description.

Almost everything in Portugal has changed over the past 30 years, he says, except its public administration. It is still languishing in the 19th century in its structure, organisation and regulation. The result? A creaking state machine that ties businesses down with red tape and makes Portugal less competitive.

Few would disagree. Study after study has shown the civil service to be overstaffed, underproductive and expensive. Its wage bill is more than 15% of GDP, against a European Union average of 10.3%. And average public-sector pay is 45 percentage points higher than in the private sector, against a differential of 27 points in Spain and only ten in France.

Portuguese business associations recently estimated that the public administration could lose 150,000 workers without any drop in efficiency. Some economists even say that it would be worth paying many of them simply to stay at home. Poor organisation is to blame, they say, not the workers.

Announcing what he says will be the most decisive reform package of his government, Mr Durão Barroso declared motivation to be the key. Measures due to take effect from next year include the scrapping of automatic promotion and the rubber-stamp A+ assessments of virtually all work. Promotion should henceforth be on merit.

Workers are to be properly assessed by their superiors, and the different public services publicly ranked by external consultants. Individual employment contracts will be negotiated for new recruits, with senior staff given more power and compulsory training. Hiring procedures will be less bureaucratic. And firing? Well, there still won't be any of that.

The prime minister guarantees that all this will happen without layoffs, which would in any case require a constitutional change. His goal, he says, is modernise, not to cut spending. At least 708,000 voters will particularly appreciate his concern.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Charlemagne

Après EU, le déluge?

Jul 3rd 2003
From The Economist print edition

Is the European Union all that stands between the old continent and war?

JUST two weeks have passed since *The Economist* recommended that the draft constitution for the European Union should be chucked in the bin, and still the delighted tributes roll in. Dorothea Negroponte of Greece muses, “Maybe we Europeans should throw Britain in the dustbin”; Sergio Zangaglia of Brussels urges Britain to have the “intellectual honesty” to leave the EU; Vincenzo Russo accuses *The Economist* of “preposterous arrogance”; a Parisian reader scolds us for “incredible rudeness”.

Why all this shock and horror? It seems that the robustly abusive nature of British political debate does not travel well across the English Channel. Just contrast the scathing criticism that Tony Blair has to put up with during an average prime minister's question time in the House of Commons with the normally decorous, somnolent calm of debate in the European Parliament. When somebody breaks that calm—as Silvio Berlusconi, the Italian prime minister did this week, with his crassly insulting comparison (unacceptable even in Westminster) of a German MEP to a concentration-camp commandant—the result is uproar.

There is a reason for the difference in tone. More than three centuries have passed since debates in the House of Commons got so heated that they led to the English civil war. But the second world war left most of Europe's politicians with the feeling that shouting across national lines in a supranational parliament is not just impolite but also potentially dangerous. A German journalist remarked kindly to your correspondent that he agreed with much of *The Economist*'s analysis of the constitution and then added, “But what's your alternative to a compromise—that we go back to killing each other?”

It is still a reassuringly long journey from the rejection of a constitutional draft by *The Economist* to the blood-soaked trenches of Verdun. But the broader argument remains. It is possible that a serious division over the proposed constitution could end up splitting the European Union. That frightens those who believe that it is the EU that has created peace in Europe and who fear that if the Union were to fracture or disappear, Europe could indeed slide back into conflict. As that kindly German journalist puts it, “Just think back to the break-up of Yugoslavia ten years ago. Germany instinctively sided with Croatia; France backed Serbia. Both countries' national presses fell instantly into line. It was quite terrifying.”

According to this alarming diagnosis, it was the ingrained habit of co-operation within the EU that prevented the situation from degenerating and older and nastier habits from re-emerging. Harold James, a historian at Princeton University, points out that the Yugoslav war was not the only crisis to buffet the EU in the early 1990s. There were also the tensions caused by Germany's reunification and the crises within the European monetary system, which raised the prospect of economic integration going into reverse. In his view, “The European Union and its institutions were a really central part of overcoming all that.”

An aide to Javier Solana, the EU's foreign-policy chief, muses that there are three broad reasons why western Europe has enjoyed almost 60 years of peace since 1945. The first is a shared memory of the horrors of war; the second is the deep economic integration that has been fostered by the EU; and the third is the intense and continuing political dialogue between the countries of the European Union, which means that “the way we talk to each other these days is so completely different. There is no longer a clear distinction between foreign and domestic policy.”

Taken together, the first and second elements might not be enough to ensure peace. After all, the carnage of the first world war left an indelible impression on the next generation of European politicians but did not prevent a further war from erupting 21 years later. And surely too much faith can be placed in economic integration. Just four years before the outbreak of the first world war, Norman Angell, a

British economist, published a book called “The Great Illusion”, arguing that war in Europe was unthinkably irrational because of the depth of European economic integration.

That, as far as the Eurocrats are concerned, leaves the third factor as the real insurance policy: political integration. EU officials firmly believe that, as one of them puts it, “The European Union is the greatest peacemaking project in history.” They point not just to the end of the 75-year-war (from 1870 to 1945) between France and Germany, but to the EU's role in cementing peace and democracy in the former dictatorships of Spain, Portugal and Greece, and in smoothing out potential conflicts over border disputes and ethnic minorities in central Europe by dangling the prospect of EU membership.

More yawns than growls

But there are also several obvious objections to the idea that the creation and maintenance of peace in Europe is the achievement of the European Union alone. The occupation and remaking of Germany by allied forces had quite a lot to do with it. So did the American security guarantee provided by NATO and the relegation of western European powers to the second rank, which meant they were no longer in a position to vie for global dominance. The fact that western Europe could no longer take the lead in shaping the global order allowed Europeans to lapse into a state of introversion, concentrating on economic development and the ever more baroque political architecture of the European Union.

More than half a century of peace and prosperity in western Europe have created a satisfied continent. The European Union's constitutional debate may raise temperatures in Brussels, but it is barely followed by the peoples of Europe at large. In the unlikely event that Europe's leaders follow this newspaper's advice and drop their new constitutional draft in the bin, the reaction of the populace would be a deep yawn rather than a rush to arms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The government, the BBC and WMD

What did you do in the war, Alastair?

Jul 3rd 2003
From The Economist print edition

Reuters

Tony Blair's chief spin-doctor is the focus of the row about whether the government misled the public over weapons of mass destruction

THE failure to find a single weapon of mass destruction (WMD) in Iraq in the two months since the war ended has fuelled public scepticism on both sides of the Atlantic. In America, according to a Gallup poll, the proportion of people who think it was worth going to war fell from 76% to 56% between April and June. The two main reasons cited were the absence of WMD and the mess in Iraq. In Britain, a YouGov poll found that Tony Blair stands to lose the trust of 23% of voters if no WMD are found; 60% said the controversy would influence their vote at the next election.

With the political stakes so high, a BBC report that the prime minister's director of communications, Alastair Campbell, “sexed up” intelligence information to hype the threat from Iraq has infuriated the government. In the long history of fights between governments and the corporation, there has never been one as personalised, prolonged or as acrimonious as this. A report by Parliament's Foreign Affairs Committee next week on WMD will be read as a verdict on the row. It will address the three central questions:

• **Did the government “sex up” intelligence information?** The BBC said that, in an intelligence dossier on Iraq's WMD published in September, the threat was exaggerated at Mr Campbell's request—in particular, to include a claim that Iraq had WMD that could be launched within 45 minutes. The BBC report cited a senior intelligence officer involved in its drafting.

The foreign secretary, Jack Straw, told MPs in a private session that the first draft of the dossier, which included the 45-minute claim, was circulated at a meeting in early September by the chairman of the Joint Intelligence Committee (JIC), John Scarlett. Mr Campbell, who was not present at this meeting, says that he first saw the draft dossier in the second week of September, when it included the claim that Saddam Hussein could launch WMD within 20-45 minutes. At a meeting later that week with intelligence officials, he is minuted as saying that for the dossier to be effective, it had to be seen as the work of the intelligence agencies, and that nothing should appear in the document unless the JIC was 100% confident about it.

Given that this version is supported by the heads of all the intelligence agencies, and that nobody from the intelligence agencies has come forward to support the BBC's version, the committee is bound to

conclude that the government's hands are relatively clean.

• **Did the BBC act properly in the way it broadcast this story?** This sensational allegation was from a single anonymous source, and the BBC failed to put it squarely to government before broadcasting it: the reporter spoke to a press officer at the Ministry of Defence who says she was told only in passing that there would be a story about WMD next day but was not alerted to its significance. The director of BBC News, Richard Sambrook, admits that “with hindsight”, it would have been better to talk to Downing Street first. He says the BBC will wait to see the committee's report before deciding whether or not to apologise. The committee's members appear to be unimpressed by what one described as the story's “flimsy basis”. Its report is likely to criticise the BBC.

• **Did the prime minister mislead Parliament?** This charge arises from the publication of a second dossier, in February. Shortly afterwards, an academic spotted that much of the material in it had come from a 12-year-old PhD thesis that was on the internet; and some of it, which included punctuation errors in the original, had clearly been copied and pasted straight in.

Downing Street was forced to confess its dodgy provenance. By then, however, the damage had been done. Referring to it in Parliament, Mr Blair had said “they [the intelligence agencies] are not publishing this, or giving us this information, and making it up. It is the intelligence that they are receiving, and we are passing it on to people.” The American secretary of state, Colin Powell, had lauded it in an address to the UN Security Council.

Mr Campbell takes the blame for what went wrong, so although Mr Blair misled Parliament, he did not know that he was doing so. Nonetheless, the committee is likely to be critical.

Even if the report criticises the government, the row has done it a service. It has, temporarily at least, distracted voters from the real issue: why Britain went to war on the basis of a threat that, it seems, wasn't there.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Tories and Europe

Neither in nor out

Jul 3rd 2003
From The Economist print edition

For the Tories, the EU is both a continuing temptation and a trap to be avoided

AFTER the debacle of the 2001 election campaign during which the Conservative leader at the time, William Hague, had talked about there being only days “to save the pound”, his successor, Iain Duncan Smith, determined that the party should shut up about Europe. If the government triggered a referendum on whether to join the euro, it would be a different matter. But the Tories guessed, correctly, that the chances of that happening in this parliament were slim.

Given that Mr Duncan Smith made his name as a serial rebel against ratification of the Maastricht treaty and has chosen a shadow cabinet that in large measure reflects his own implacable views about European integration, this was a remarkable decision. Mr Duncan Smith appeared to think that while most voters were probably moderately Eurosceptical, few shared his deep hostility to the EU.

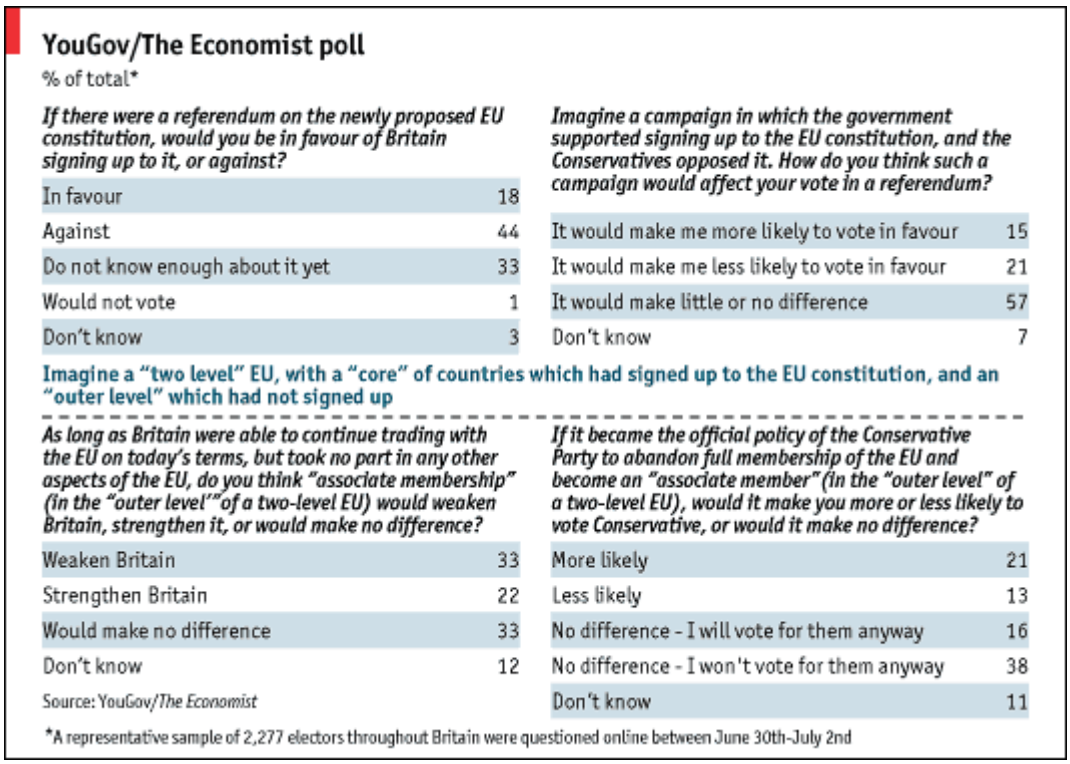
However, the argument over the European constitution (which, among other things, absorbs a succession of pre-existing treaties, the more important of which were actually ratified by previous Conservative governments) has made the party's silence on Europe hard to sustain. The Tories have enjoyed heaping scorn on the draft that emerged from the convention on the future of Europe, chaired by Valéry Giscard d'Estaing, a former French president, and have demanded a referendum on the final text. No matter how successful the government is in blocking the things it finds objectionable, the Conservatives will oppose ratification.

In itself, this is not surprising. But it will force the Tories to do something they would rather not do: it will compel them to define what kind of Europe they would sign up to.

So far, the constitution has caused the government nothing but embarrassment. It has been pressed to hold a referendum, which would happen over Tony Blair's dead body. But it thinks some good may yet come out of it: the issue may flush out the Tories' suppressed desire to leave the EU altogether. And it reckons that, although voters may not be very keen on Europe, the idea of pulling out altogether would frighten them.

The Tories say the idea that they want to pull out is nonsense. The evidence, however, suggests that this is semantics. David Heathcoat-Amory, the Conservative MP who served on the convention, argues in a pamphlet published by the Centre for Policy Studies, a right-wing think-tank, that the constitution is likely to be so unacceptable that to get “the relationship with the union it wanted”, a future Conservative government would have to negotiate “an associate membership of some kind”.

Shadow cabinet members, such as Michael Howard, the shadow chancellor, bridle at the concept of “associate membership”; but Mr Howard's view is hard to distinguish from that of Mr Heathcoat-Amory. He says that he is in favour of the single European market and a Europe-wide approach to environmental matters. That's it.



YouGov/The Economist poll

% of total*

If there were a referendum on the newly proposed EU constitution, would you be in favour of Britain signing up to it, or against?

In favour	18
Against	44
Do not know enough about it yet	33
Would not vote	1
Don't know	3

Imagine a campaign in which the government supported signing up to the EU constitution, and the Conservatives opposed it. How do you think such a campaign would affect your vote in a referendum?

It would make me more likely to vote in favour	15
It would make me less likely to vote in favour	21
It would make little or no difference	57
Don't know	7

Imagine a "two level" EU, with a "core" of countries which had signed up to the EU constitution, and an "outer level" which had not signed up

As long as Britain were able to continue trading with the EU on today's terms, but took no part in any other aspects of the EU, do you think "associate membership" (in the "outer level" of a two-level EU) would weaken Britain, strengthen it, or would make no difference?

Weaken Britain	33
Strengthen Britain	22
Would make no difference	33
Don't know	12

If it became the official policy of the Conservative Party to abandon full membership of the EU and become an "associate member" (in the "outer level" of a two-level EU), would it make you more or less likely to vote Conservative, or would it make no difference?

More likely	21
Less likely	13
No difference - I will vote for them anyway	16
No difference - I won't vote for them anyway	38
Don't know	11

Source: YouGov/*The Economist*

*A representative sample of 2,277 electors throughout Britain were questioned online between June 30th-July 2nd

This is in line with a pamphlet written by Bill Cash, published in September 2000, entitled "Associated, Not Absorbed". Mr Cash, who has devoted his political career to reversing Britain's accession to the Treaty of Rome, is the party's spokesman on constitutional affairs.

As for Mr Duncan Smith, in 1996 he introduced a private member's bill to give Parliament primacy over European laws. Along with 16 other Tory frontbenchers, he is a vice-president of Conservatives Against a Federal Europe. In June 2000, CAFE stated its aims as including "a separate relationship with the EU". The pressure group's website says that it "will remain closed while Iain Duncan Smith is leader of the party", presumably because it reckons he is doing its job for it.

It seems plain that these senior Tories want a fundamental renegotiation of Britain's relationship with the EU and the withdrawal from all its core activities other than the single European market. Yet they implausibly insist that this is somehow compatible with remaining a full member of the EU: any talk of "associate membership" is firmly sat on.

However, as our poll (see table) suggests, the Conservatives' reticence could cost them votes. Although a lot of people are honest enough to say they don't know enough about it, among those who think they do, the government's assurances about the innocuousness of the new constitution are not believed. But the findings that should really make the Conservatives think again are to do with associate membership. If that became explicit Tory policy, they might attract 8% more votes—not enough to ensure a general election victory, but sufficient to make the result of the next election a lot closer.

Crucially, when asked whether being on the periphery of the EU would weaken or strengthen Britain, only a third thought it would make Britain weaker. Although the government would do its best to frighten voters with the consequences, it might find it uphill work.

Given what they and the electorate seem to believe, what is stopping the Tories from coming out for associate membership? As Mr Blair observed in the Commons last week during an exchange with Mr Heathcoat-Amory: "it [associate membership] is a perfectly honorable position" and one that "represents a fundamental dividing line between the two parties." He makes it sound so tempting. Which is what makes it sound like a trap.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Foxhunting

Blooded

Jul 3rd 2003
From The Economist print edition

The government's weakness shows in its defeat on foxhunting

Get article background

SMALL issues sometimes have large symbolic power. To those who enjoy thundering across the countryside in red coats after foxes, foxhunting symbolises the ancient roots of rural lives. To much of the Labour movement, it symbolises the brutality of the upper classes. To foxhunting's supporters, Labour's 1997 manifesto commitment to ban it symbolises the party's metropolitan roots and hostility to the countryside. And to everybody watching, the current mess over foxhunting symbolises the government's weakness.

Surprised by the ferocity of rural feeling, the government had backed away from its promise of a ban and had prepared a compromise that would have allowed a few of the 300 or so hunts in England and Wales to survive, albeit under the strictly limited conditions of being a fancy form of pest control. Tony Blair invested a great deal of time in telling his back-benchers that this was “an elegant and sophisticated solution”. But Tony Banks, a Labour left-winger, proposed a total ban. The government, seeing the way the wind was blowing, withdrew its compromise and the ban went through on June 30th by 362 to 154.

The vote is a measure of how stroppy MPs are feeling. More than 60 of Mr Blair's ministers and their aides voted for the ban, and about half of his whips did. And his decision to withdraw the compromise rather than fight for it shows that these days he is more afraid of offending the party than the countryside.

But this issue is still not settled. The new law has to get through the House of Lords, which will probably try to ease the ban. If so, the Commons will toughen it up again and the measure will ping-pong back and forwards until the government uses its powers to override the Lords.

Then there are the courts. Scotland introduced a sort-of ban last year. Dogs are still allowed to flush out a fox which then has to be shot before it is ripped apart. But that can go wrong. Two Scottish hunt employees are waiting to find out if they will be prosecuted for a hunt in which the dogs got overenthusiastic. It remains to be seen whether rural magistrates will convict such law-breakers.

The ban may also contravene European human-rights law. One such challenge is grinding through the Scottish courts and may end up in the European Court of Human Rights. And even if it does get through Parliament and the courts, according to Alastair McWhirter, chief constable of Suffolk, it will be unenforceable. The huntsmen's horns will be ringing in Mr Blair's ears for some time yet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Germany and Britain

Bringing back the romance

Jul 3rd 2003
From The Economist print edition

It's a struggle to sell Germany to the British

EDUCATED Germans—that means most of them—are drawn to Britain. They like its tradition, colour and liberating chaos. Some 2.5m of them visit Britain every year. ZDF, Germany's state-owned television broadcaster, puts out about 20 stories a week on British news and culture.

Alas, the British find the idea of Germany less alluring. That's why, on July 2nd, Thomas Matussek, Germany's ambassador to Britain, hosted a conference on “Branding Germany” to work out how to sell Germany to the British.

The British used to be fascinated by the home of Romanticism. The first foreign package holiday was a tour of Germany organised by Thomas Cook in 1855. Until the early 1930s, a pilgrimage to the land of Schiller, Goethe and Thomas Mann was *de rigueur* for serious-minded students. Events intervened; and in the late 1930s and early 1940s, as the conference policy paper delicately explains, Germany suffered from “over-branding”. Since then, Germany has been understandably nervous about promoting itself abroad. But reunification and the federal government's move to Berlin have prompted Germany to think again about its image.

Selling Germany in Britain will be a slog. Despite a slew of German exhibitions in London this year—Albrecht Durer, Max Beckmann and Ludwig Kirchner among others—most British are rather indifferent towards Germany. They don't mind the BMWs, the Volkswagens and Miele dishwashers, but they are not much interested in the high culture so important to the German middle classes.

Moreover, the cheaper flights get, the easier it is to travel south for a suntan. Only 590,000 British residents visited Germany on holiday last year (that included trips home by the 100,000-or-so Germans living in Britain), while 7.4m went to France and 8.2m to Spain. But a rotten climate clearly does not rule out a healthy tourist industry, as Britain shows. Think of all the Germans who visit Britain. Germany wants a bit of reciprocity.

But a whole generation of British schoolchildren has grown up associating Germany only with Hitler. There is almost nothing on television about modern Germany, and masses, still, about the war—12 programmes in one six-day period logged for the conference. Around 80% of history A-level students opt to study Nazi Germany: it helps them through exams because it is the only subject they can study for the national curriculum, GCSE and A level. Teachers like the subject because its horror and dark glamour compel attention. Most history students cannot study post-war Europe even if they want to.

This may change. Partly in response to these concerns, Charles Clarke, the education secretary, has launched a review of the way history is taught. The conference called for more exchange programmes for schoolchildren. In the meantime, the average Briton is thus far more likely to meet a German on the Costa del Sol than on his own soil—with a competitive dash to the sun-loungers and buffet table.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Employment law

Time's up for ageism

Jul 3rd 2003
From The Economist print edition

Whitehall plans to ban age discrimination. The devil will be in the detail

LIFE expectancy for men in Britain has risen by five years to 76 since 1981, and ten years since the 1940s. The heavy manual work that used to kill off the labouring classes has itself been largely killed off by technology. Women now live beyond 80. Yet the “normal”—and for many employees mandatory—retirement age was for decades 65 for men, 60 for women. And when anti-sexism came in, the tendency was to equalise that age downwards. Even Britain's brightest civil servants are normally retired at 60. Now the government, supposedly obeying an EU directive, but really because it is worried by the growing pensions burden, is to ban age discrimination. The Department of Trade and Industry published a green paper this week; a law should be in force in October 2006.

The ban will be wide. It will cover recruitment, training (including entry to higher education), promotion, pay, job-retention and—not least—retirement. In principle, enforced retirement at a given age will be banned; but the government is open to the idea that some employers could “objectively” justify a fixed age, and/or that any employer could lawfully push workers out at 70.

Will it work? The Confederation of British Industry supports a ban, but fears an “explosion” of employment-tribunal cases: were you really denied the job for being too young, or for lack of experience? For being too old, or for being “past it”? The Institute of Directors, often loud against red tape, is improbably relaxed. But neither speaks for the small businesses that often suffer most from the burden of employment law.

It will be hard too to define what is a justifiable requirement for the post concerned. “Training requirement”, says the green paper hopefully, but that nicety must surely vanish in the wash: the air-traffic controller whom the paper instances needs fitness and concentration to do the job, not just to be trained for it. And here oceans of uncertainty will open wide. OK, Spearmint Rhino can hardly be forced to hire grandmothers. But do women news-readers need a young face? To read news, plainly not: but how many now are over 45? Is this purely and simply unfair?

Supposing the proposed law does make a difference, the obvious gainers will be Britain's 5.5m employees aged over 50. Some supermarkets are happy to put 60-year-olds at the check-out: they are more reliable, says one such manager. But most people pushed out of a job at 55 or even 50 have no great hope of getting another. It is not by chance that the 50-plus age-group includes 1.1m supposedly self-employed; that, at best, is where redundant factory workers of that age tend to end up.

And the benefits and costs? If it really keeps oldies in work, the macroeconomic gain could be large: one study put the cost of low employment among the 50-plus brigade at 2% of GDP; another study said 3%. Such people fell out of the workforce in droves during the Thatcherite shake-out of the 1980s; and again in the cold early 1990s. But the figures have crept up since: 62% of British men and 45% of women in this age-group are at work. These are well above average EU figures, but still far below those for younger people.

As for the direct gains or costs to employers, a 50-page study with the green paper attempts to supply figures, with scant success. If you can write “cost” for figures that your own text elsewhere calls “benefit”, or make 275,000 x 0.01 x £20,098 x 1.3 equal £29m (go on, try it, you old fool), there's plainly a job at the DTI for you. Even if you figure your way past such slips of the pen, you might as well not have bothered: when the raw material is heroic assumptions, the (pretty trivial) net outcomes are guesstimates at best.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

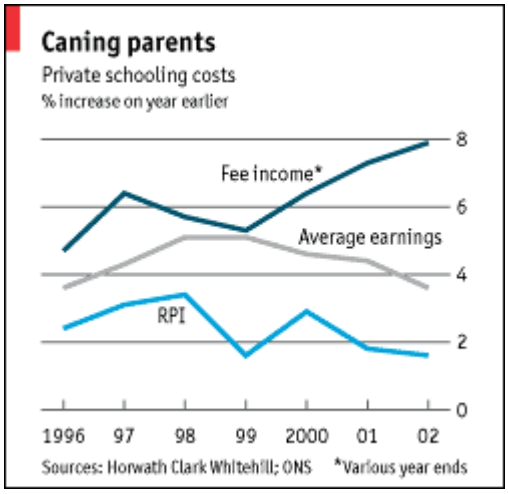
About sponsorship

Private schools

Old school ties

Jul 3rd 2003
From The Economist print edition

Are Britain's top fee-paying schools running a cartel?



PARENTS of the 6% of children at independent schools will be getting letters around now telling them that fees are rising by something like 10%. They may not, therefore, be surprised by the news that the Office of Fair Trading (OFT) is investigating accusations that the best-known of them—such as Eton and Harrow—are running a cartel to keep fees up. If the OFT investigation, which is likely to take several months, leads to a successful prosecution, headmasters and bursars concerned could face up to five years in jail.

At first glance, the idea that there is a cartel in this business looks plausible. The cost of independent schooling has gone up far faster than inflation (see chart). The fees at the best schools in each category are remarkably similar—around £6,400 a term for top boarding schools. Several senior school figures have admitted meeting and comparing fees.

Markets with high barriers to entry are susceptible to cartels; and the barriers to entry into the schools business are huge. Although independent schools in the south of England are heavily oversubscribed, and most seem to have healthy finances, there are few new entrants to the market. The main reason is space. Existing schools tend to have excellent sites, acquired in easier times. For newcomers, finding suitable buildings is hard, and gaining permission to use them as schools even harder: locals don't want to be swamped with traffic and teenagers.

So does all this add up to *prima facie* evidence of collusion? No. The main reason fees have been rising is that teachers' wages make up the bulk of costs—around 60% for a typical day school. Sharp rises in state school pay—particularly for the best teachers, the ones independent schools want—have driven up wages in private schools. According to the main annual survey of independent school finance, published by Horwath Clark Whitehill, an accountancy firm, teaching staff costs rose 6.5% in 2001 and 5.2% in 2002, while fees rose 7.3% and 7.9%. This year payroll costs are believed to have gone up by around 15%, largely due to a 60% hike in contributions to the teachers' pension scheme.

New regulations are also pushing costs up. Communal showers, for example, have had to be replaced with individual cubicles. Adapting old buildings to modern standards of hygiene and privacy is particularly expensive because of rules aimed at preserving historic architecture. Regulation also pushes up staff costs: somebody has to write the numerous “risk assessments” required for activities.

Third, although the top schools charge similar fees, outside that bracket there is a wide range to choose from. The Girls' Day School Trust, a mutual, runs a chain of 25 no-frills schools charging £2,159 per term for schools outside London. Last year, according the Independent Schools Council, 36 boys' boarding schools charged less than £5,000 a term; 66 £5,000-6,000; 41 more than £6,000.

But most parents do not want cut-price boarding schools in remote parts of the country. By far the biggest demand is for day schools in London and the south-east. These schools are heavily oversubscribed and have a lot of pricing power. Some of them think they could raise their fees by 50% and still fill all their places with the children of the super-rich. Headteachers don't want to do that because it would weaken their claim to charitable status and limit their ability to select the cleverest children and thus get the best results. So if they have been colluding, it may be to keep the fees down,

not up.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

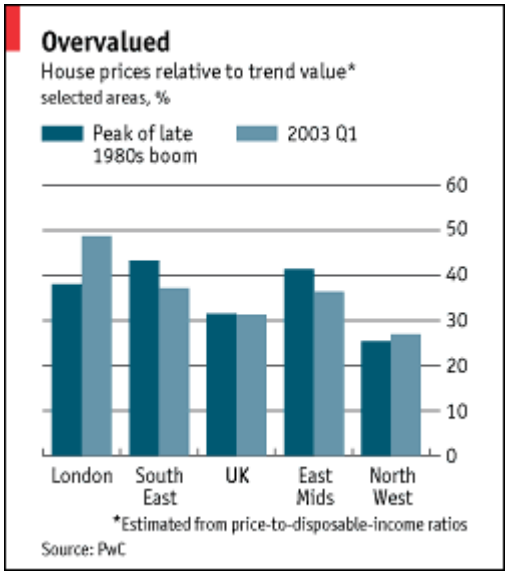
About sponsorship

House prices

Down they come

Jul 3rd 2003
From The Economist print edition

But the roof won't fall in like it did last time



SINCE 1995, house prices have increased by almost 150%. The rise in housing wealth has helped sustain the longest consumer-spending boom since the war. But now the housing-market bubble is starting to subside.

House prices are still rising across the country, according to the Nationwide building society. Indeed they rose by 19% in the year to June. But that's quite a bit lower than the peak of 26.5% in the 12 months to January. And the monthly increase of 0.9% from May to June was equivalent to an annual rate of 11%.

The national picture disguises a sharp regional divergence. In the north, house prices are still rattling ahead. But in London, they fell in the second quarter compared with the first three months of the year, according to the Nationwide.

The decline in London house prices is an ominous sign. As in earlier cycles, the capital has been the epicentre of the house-price explosion. A sharp rise in house prices has then rippled out to the rest of the country. The fall in London house prices thus presages an eventual decline across the country even though the north is still booming.

The Bank of England is expecting house-price inflation to slow to a halt over the next year. But some forecasters think that a hard landing is more likely. Cambridge Econometrics is forecasting a fall of about 10% in British house prices by the middle of next year.

A hard rather than a soft landing looks more likely. In relation to income—the main determinant of house prices in the long run—housing is as over-valued as at the last peak in the late 1980s. So either house prices must fall or income must rise to restore trend valuations. In the past, much of the adjustment was through rapid growth in income. But now earnings growth is much lower because of the fall in consumer-price inflation. So more of the adjustment will have to come through actual declines in house prices.

Over the past 30 or so years, the housing-market cycle has been interwoven with the general business cycle in Britain. Most recently, a boom in both house prices and the economy in the mid-to-late 1980s was followed by a wrenching bust in the early 1990s. So the prospect of another housing-market bust is naturally a cause for considerable alarm.

But there are good reasons to expect less of an economic hangover this time. In the late 1980s, interest rates were raised to clamp down on inflation. They then stayed high because Britain lost control over monetary policy after joining the European exchange-rate mechanism. Unemployment rose sharply and there was an intense squeeze on household income from high mortgage-interest payments.

Now inflation is low and under control. The immediate cash burden on households from servicing their mortgages is manageable even though borrowing has risen sharply. As a result, the proportion of households in arrears on their mortgages is at a 20-year low. Although unemployment has started rising, the labour market has been remarkably resilient during the economic slowdown.

Since the economic fundamentals are sounder than they were in the late 1980s, the impact of a housing-

market decline will be more limited. Suppose, for example, house prices were to decline by 20% over the next three years. The effect would be to lower consumer-spending growth from 1.9% to 1.7% in 2004 and from 2.2% to 1.6% a year in 2005 and 2006, according to PricewaterhouseCoopers. The reduction in GDP growth in 2005 and 2006 would be lower still, around 0.3% a year. By contrast, consumer spending stagnated between 1989 and 1992. A decline of 1.6% in 1991 was a key reason why the economy shrank that year by 1.4%.

Together with the fall in the pound, the weakening housing market heralds a protracted period of sluggish consumer-spending growth. This will be less enjoyable than the “feel-good” economy of the last few years. But it will be a distinct improvement on the “feel-bad” experience of the early 1990s.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bagehot

The Tories' Catch-22

Jul 3rd 2003
From The Economist print edition

Things are looking up for the Tories, but there's one little problem

TO TALK about the Tories being on a roll would be overdoing it. But ever since surprising themselves (and everyone else) by winning 600 seats in the local government elections a couple of months ago, things do seem to have been going their way.

The latest evidence for a revival of sorts is that for the first time since a blip during fuel-tax protests three years ago, the Conservatives have nosed ahead of Labour in the opinion polls. Mostly, but not entirely, this is due to the government succumbing to a fairly sharp attack of mid-term blues, something which didn't happen in the previous parliament.

The protracted semi-secret haggling between the prime minister and the chancellor over how to present a united front on the euro achieved exactly the opposite. The news blackout encouraged the press to paint a picture of bitter division over Europe at the top reminiscent of the rows that undermined successive Conservative governments. Voters don't like quarrelsome parties and, according to a MORI poll this week, 83% now believe that Labour is split over the euro.

The bungled reshuffle that followed the euro announcement suggested that the government was also becoming less competent. If it has such difficulty organising itself, a reasonable conclusion might be that its chances of successfully reforming the public sector are slim.

But the best news for the Tories is the ebbing of trust in Mr Blair, who continues to be dogged by accusations that he misled the country over Iraq's weapons of mass destruction. Mr Blair's supporters claim that the griping comes from people who were always against the war and are using the row as a new stick with which to beat the prime minister. But it's worse than that. Many people who did back Mr Blair over Iraq feel let down. They don't have to think that the prime minister deliberately lied, only that his judgment on a very important issue was flawed. According to that MORI poll, 38% trusted Mr Blair before the beginning of the year, but no longer do. A government that appears divided and is losing voters' trust as well as its reputation for competence is vulnerable.

The Conservatives have not been merely passive beneficiaries of the government's failings. They have, in the European constitution, found an issue that should play to their strengths if—and it is, admittedly, a very big if—they don't allow themselves to get carried away (see article). So far, despite the temptation to go over the top with guns blazing that most of the Tory frontbench undoubtedly feels (not least that old Europhobe, Iain Duncan Smith), they have been sufficiently disciplined to concentrate their fire on Mr Blair's refusal to hold a referendum. Given the frenzy that the *Daily Mail* and the *Sun* have worked themselves up into, they really don't have to do much at this stage other than to go on repeating that the voice of the British people must be heard.

Some senior ministers admit privately that Mr Blair was too hasty in ruling out a referendum. Had he only said that any decision on a referendum could wait until next year, after the constitution is finalised, he would have been on stronger ground.

Although Europe and asylum-seekers continue to tug at Tory heart-strings, Mr Duncan Smith appears to have learned the lessons of the last election well enough to keep the focus on public services. The promise of a return to free university tuition may be cynical (and do nothing to address the twin evils of chronic under-funding and excessive government interference that afflict higher education) but it is nicely calculated to go down well with middle England, not least with the kind of young voters who would never previously have thought of voting Conservative, while adding to the unease of Labour backbenchers. On health too, the Tories have started to land a few punches. Proposals for “patient's passports”—in effect,

health vouchers that can be used to buy treatment in any hospital—could prove unexpectedly popular.

A further sign of the agenda gradually moving in the Conservatives' favour was this week's warning by the new governor of the Bank of England, Mervyn King, that the taxes being levied to bolster public services would mean the end of the “feel good” economy. If the politics of tax-and-spend is on its way back that can only be to the Tories' advantage.

A fly in the ointment

Does all this mean that the “tipping point” of Conservative dreams is nigh? In that confidence in the government may now be in irreversible decline, perhaps. But not in the sense that the Tories are any closer to winning the next election.

The obstacle is Iain Duncan Smith. His leadership is not wholly bad. When things looked bleaker a little while ago, he might have reached for the xenophobia, as his predecessor, William Hague, did at a similar point. Mr Duncan Smith didn't. But Tory MPs, who writhe at his inept performances in the Commons, know that their leader lacks what it takes to be prime minister. They have seen him shrink, not grow, in the job. As a real Conservative revival begins to look at least possible, Mr Duncan Smith will become increasingly hard for them to bear.

Unfortunately, bearing him is exactly what they will almost certainly have to do. Thanks to the convoluted procedures for getting rid of Tory leaders who don't want to go—the political equivalent of a corporate poison-pill defence against takeover—even Mr Duncan Smith's most militant critics quail at what is involved. Unless he resigns, there is almost no prospect of removing him before the next election. And why should he quit just as Tory fortunes are turning?

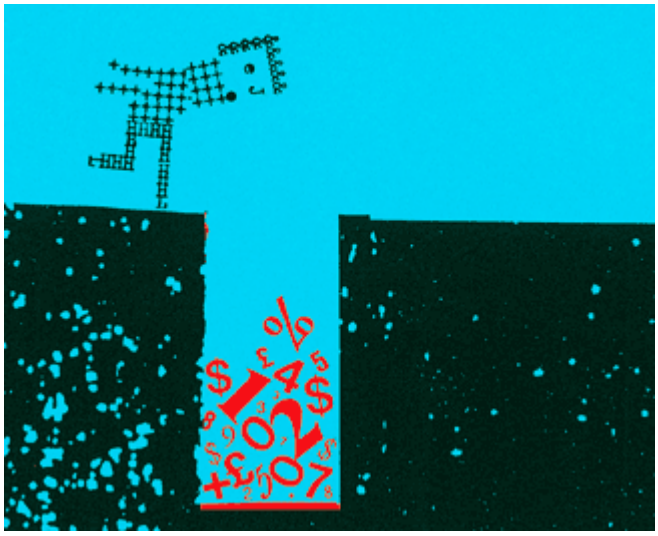
The Catch-22 for the Tories is this: the better they do under Mr Duncan Smith, the more they will wish for a different leader. And the less likely it is they will get one.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Other people's money

Jul 3rd 2003
From The Economist print edition



The fund-management industry used to make money without even trying. Now it has to work for its living, says Tamzin Booth

LIFE as a fund manager in the 1990s was sweet. Sitting on a mountain of investors' money during the bull market was a powerful, highly paid and fairly easy job. Fund managers rarely got fired, even if they performed persistently worse than their peers. And there were plenty of perks. Stockbrokers competing to buy and sell shares for fund managers lavished treats on them—polo lessons, for instance, or test-driving the latest Porsche near the factory in Stuttgart. A stockbroker whose fund-manager client had handed back his tickets for the New York Yankees at the last minute spotted the client watching the game from better seats, courtesy of a different bank. At the time, this was nothing unusual. The fund managers' customers—pension funds, mutual funds and ultimately millions of individuals saving for things like education and retirement—were unconcerned because their wealth was rising along with the stockmarket.

Now their world has changed. Fund-management leaders have reason to be depressed, says Charles Ellis, the founder of Greenwich Associates, a consulting firm in Connecticut. A huge chunk of their investors' money has been wiped out by the fall in the world's stockmarkets over the past three years. Fund managers are having to explain the losses—to individual investors whose plans for the future have been wrecked, and to people entrusted with insurance or pension money who can no longer keep the promises they made to their customers in better times.

The bear market has also dealt a severe blow to the industry's own business model. Fund managers live on a percentage of the money they invest on behalf of others (“assets under management”). Those assets have plunged in value, partly because of the drop in stockmarkets and partly because people have started to move their money out of stocks and back into the bank (see chart). In America, the total assets managed by firms tracked by Morgan Stanley fell by 30% between the first quarters of 2000 and 2003.

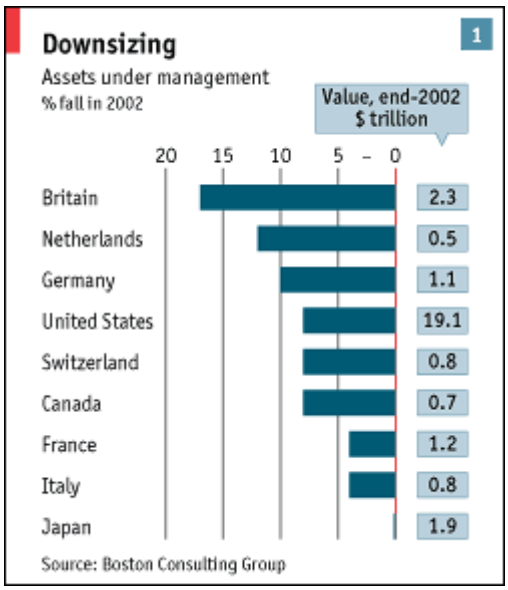
Last year's model

Yet even as revenues shrink, fund managers' costs remain at the bloated levels of the late 1990s. On the volume of assets they have now, about half the fund managers in London are losing money every day, says Glyn Jones, chief executive of Gartmore Investment Management, a British fund-management company.

That fund-management businesses can lose money has come as a shock to the banks and other financial institutions that snapped them up at high prices during the past decade. When things are going right, meaning that the stockmarket is rising steadily each year, there are few industries that can legally make as much money as this one. A fund-management firm with a cost base of, say, $150m can invest and administer $80 billion of its customers' money just as easily as $50 billion, so the fee on the extra $30 billion goes more or less straight to the bottom line. Unlike banks, which have to comply with the Basel capital regime, fund managers have not needed to undergo a capital-adequacy test. They have small capital bases and therefore, in the good times, enormous returns on equity—often as much as 30%, sometimes much more. And fees just kept rolling in steadily year after year.

Now, bosses of banks and insurance companies are trying to rid themselves of their asset-management arms. Commerzbank, a struggling German bank, has tried to sell Jupiter Asset Management, a British fund manager, and Zurich Financial Services has just disposed of Threadneedle, also British. Many asset-management businesses are being quietly hawked around, especially in Europe, though the managers themselves may not know it yet.

Their parent companies now think that fund management thrives only when stockmarkets soar—not the sort of business to offset the volatility of, say, mergers and acquisitions. They fear that the days of high growth (revenues grew by over 15% a year in the 1990s, according to a joint report by UBS, an investment bank, and Mercer Oliver Wyman, a consultant) may be gone forever. Disenchantment with the way fund management works, combined with excess capacity, is likely to bring a long wave of consolidation.



And yet the long-term outlook for fund management should be bright. Populations in the developed world are getting older and living longer, meaning that more people will need to live on invested capital. Governments are trying, slowly, to shift the burden of paying for pensions off the state and on to individuals. That will boost demand for savings products.

Optimists in the fund-management industry, therefore, are waiting for the markets to start rising again, hoping that investors will come back to equities and high profits will return. But things may never be quite the same again, because these days all financial services are finding themselves under much closer scrutiny. So far, it has been mainly investment banks and auditors that have come under attack for sharp practices. The fund-management industry, with trillions of dollars of other people's money in its care, has seen surprisingly little fraud, points out Alan Brown, global chief investment officer of State Street, an American fund-management firm. But people in the business, as well as regulators, reckon that some of the industry's practices are damaging investors' interests.

In Britain, two reports on fund management written in the past couple of years, by Ron Sandler and Paul Myners respectively, pinpointed various problems. For instance, “softing” arrangements, common in many rich countries, involve a fund manager paying commission to stockbrokers out of the investor's pot of money—over and above the percentage fee for fund management. In return for these commissions, fund managers get newswire services, access to people who analyse stocks—and, from time to time, tempting invitations. Mr Myners said that softing ought to stop.

In June, Richard Baker, chairman of a congressional sub-committee on capital markets, insurance and government-sponsored enterprises, introduced legislation that would require investors to be given more information about mutual-fund fees and other features of the business, such as fund managers' pay. Part of the reason for the increased scrutiny is simply that fund managers are losing money for their investors. When markets earned them double-digit returns, few people looked closely at the costs of fund management, either the visible or the hidden sort. But in thin times they take an interest in such matters, squeezing the industry's margins.

More radical reform might follow, especially if the stockmarkets continue to produce disappointing returns. The most important conclusion of the Myners report was that pension-fund trustees—who are big clients of the fund-management industry—need to become more educated about financial matters. Trustees are the guardians of pension money, yet many of them, it seems, do not know enough about investing. In America and Britain, many of them put too much money in equities. As it happens, shares are the most profitable asset class for fund managers and for the investment banks that serve them.

“Our industry and the stockbrokers ripped off the trustees and got ourselves a lot of Porsches in the process,” says a fund manager at a London-based outfit owned by a European bank.

Greed and fear

Individual savers are even less likely than trustees to make sensible investment decisions. They tend to be motivated by greed and fear, which the fund-management industry plays on. Because its customers have a limited understanding of financial products, the industry has always faced a dilemma. Should it sell people what they think they want, or should it offer them the conservative investments that may be more appropriate for their future needs?

During the late 1990s, many fund managers decided to put their own business interests first and pushed products they knew would sell, whether or not they would turn out to make money for their customers. “Now they are reaping what they sowed,” says Barry Bateman, vice-chairman of Fidelity International. The present travails of Janus and Putnam, two American fund managers that specialised in growth funds, serve as a warning to their peers: their assets under management fell by over 40% between the first quarters of 2000 and 2003.

Mr Bateman hopes that lean times will cause the most unscrupulous fund managers to leave the industry; but there is little chance that investors will ever stop clamouring for the latest hot investment product at the wrong point in the economic cycle. Up to now, the industry's regulators have mostly relied on the “buyer beware” principle. But next time the industry markets inappropriate products to savers, they will be watching more closely. After all, it is governments that ultimately underwrite people's financial survival in retirement.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Pension pain

Jul 3rd 2003
From The Economist print edition

Who's to blame for the big hole in many pension funds?

FUND managers invest money for two kinds of customer: the retail business, which serves individuals, and the pension funds and endowments (for bodies such as universities and charities), known as institutional clients. Retail investors who have lost a chunk of their savings cannot do much about it. Pension funds, on the other hand, can take billions of dollars away from a fund manager at the drop of a hat. They could be a force for change.

Assets of corporate and public pension funds and endowment funds in America together fell in value by just over $1 trillion between 2000 and 2002, according to Greenwich Associates. During that period, the largest corporate pension funds lost an average of $3 billion each. Many of them now do not have enough money in the pot to pay the promised amounts to pensioners in future. Comparing available funds with forecast liabilities, says Greenwich Associates, nearly 30% of corporate pension schemes in America were in deficit at the start of 2002. In Britain, says Watson Wyatt, a firm of actuaries and investment consultants, the fall in stockmarkets has blown a hole of £65 billion ($110 billion) in big companies' pension funds. Seven of them have pension-fund liabilities of more than half of their market capitalisation. In the 12 euro-zone countries, Watson Wyatt estimates that one-third of the 300 largest listed companies have pension-fund deficits, totalling about $220 billion.

Permissive accounting rules have allowed companies to smooth out the effect of stockmarket volatility on their pension funds, but that will change. In Britain, a tough and unpopular new pension standard called FRS17, to be fully enforced from 2005, says that companies must account for all their pension assets at market prices, and that deficits must be deducted immediately from total gains and losses, or surpluses added back. In America, from next year, the Financial Accounting Standards Board will require companies to publish details about their defined-benefit pension assets and liabilities as well as their assumptions about returns.

All this has generated a lot more interest in pension funds, not just from trustees but from chief executives too. Company bosses want to know how their pension funds have got themselves into a mess, and how they can stop it happening again. Some pension-fund trustees, it seems, cast aside an old investing saw: don't put all your eggs in one basket. In Britain, they put 70-80% of their money into shares, two-thirds of it in the domestic market. American trustees were more conservative, investing about 60% in equities, and European pension funds put in a modest 40%. Mature pension funds, with a high proportion of retired employees to people still working, are in the worst straits, because they have to pay out the soonest and get less income from current contributors.

Pension funds now have to decide whether to stick to their high allocation to equities and pray for stockmarkets to go up, or to rethink their investment strategy. A simple idea, currently much in vogue, is that pension funds should pay more attention to the nature of their future liabilities when they pick their investments. Some people argue that since defined-benefit pension funds' liabilities are correlated to wage growth and inflation, long-dated inflation-linked bonds would be a better match than equities.

Crunch time

Shifting out of shares and into fixed-income investments now, though, could mean locking in equity losses and buying into bonds at a point when they are widely believed to be overvalued already. Taking

less risk would mean a lower return over time. To achieve the same financial goals, a company or an investor would have to invest more.

Companies are already stumping up more cash for their pension schemes and are trying to find ways to cut their future pension liabilities, such as closing defined-benefit schemes to new entrants. In future, most employees will be offered defined-contribution plans instead, meaning that they, not the employers, will shoulder the risk that their investments will produce insufficient returns for their retirement. Meanwhile, pension funds stuck with defined-benefit liabilities are thinking hard about changing their asset allocation.

In March, several large pension funds around the world launched a competition. They challenged fund managers to come up with a proposal for running pension assets over 20 years, much longer than the current average of about five years. Peter Moon, chief investment officer of Britain's Universities Superannuation Scheme, one of the group's leading funds, with £20 billion to invest, says that fund managers do not match pension funds' assets with their long-term liabilities. If they do not change their ways, he says, they could get disintermediated. Some pension funds in Europe already manage their own money, though they need to be big to do this successfully.

Fund managers will argue, with some justification, that they are not responsible for the situation pension funds find themselves in. A pension fund is often an orphan within a company, says John Ralfe, a pension consultant who in his previous job at Boots, a British chemist, moved its entire pension fund out of equities into bonds: lots of different people have an interest in it, but “no one has their arms around it completely”.

In Britain, a third of a pension fund's trustees must come from the shop floor. At American companies that have trade union representation, half must be from the workforce; most of these people are not investment experts, any more than some of the grander sorts of trustees. Clive Gilchrist, managing director of BESTrustees, an independent pension-trustee company in London, says that some boards of trustees do not like to meet too often because they do not know how to use their time together: “After noting the reports from the fund manager, what else is there to do?”

Because they are often ignorant, trustees are terrified of being sued by pension-fund members, so they rely heavily on advice from consultants. Yet it was the pension-fund consultants, working on actuarial principles, that advised their clients to put a lot of money into equities. In the past, pension funds used to give fund managers “balanced” mandates, which left them some discretion to move money between asset classes, but in recent years balanced mandates have mostly disappeared. Instead, consultants do an asset-liability study for the fund every three years and set an asset allocation which usually remains unchanged until next time.

Pension-fund consultants took too rosy a view of equities and overestimated their long-term returns when markets were overpriced, says Andrew Smithers, of Smithers & Co, an independent economic-research company in London. They also advised companies that a lower allocation to equities would mean far higher contributions to their pension funds, because the return on bonds would be lower.

Some of those consultants gave a probability of only 1% to the bear market of the past three years, says Nathan Gelber, chief investment officer of Stamford Associates, an unconventional pension-fund consultancy in London. Instead of considering what it would take for equity returns to revert to their historical mean, he says, they looked at the number of stockmarket corrections in the past. “They are steeped in a number-crunching ethos,” he explains, “and seem to pay less attention to investment theory.”

“Actuaries are to blame for the hole in the pension funds,” says the head of a London-based fund manager. “Fund managers had asset allocation taken away from them, so you can't blame us.” In fact, most fund managers resent the power of the pension-fund consultants, but they cannot criticise them in public because they need to be on the consultants' list to have any hope of winning new business. Despite their power, however, pension-fund consultants are not particularly profitable. Lacking the resources to invest in staff and original work, they generally look at the practices of big pension funds and persuade the rest to do the same.

They are also largely unaccountable, because there are no figures to record their success at picking fund managers. Avinash Persaud, head of global research at State Street in London, says they are just a sort of information-clearing service. In the early 1990s, for instance, they all recommended the same big four British managers to pension funds—Gartmore, PDFM, Schroders and Mercury. “Trustees were led by the

nose by the consultants," says Paul Myners, who wrote the aforementioned review of institutional investment in 2001. He wants to put pension-fund trustees on investment-training courses to encourage them to challenge the consultants.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The law of averages

Jul 3rd 2003
From The Economist print edition

By definition, not everybody can beat the index. Should fund managers try?

FOR most of the past century, stocks and bonds were only for the rich. Then came mutual funds. These allowed ordinary people to pool their resources with those of other small investors, which gave them access to professional fund managers and allowed them to diversify among different stocks. Mutual funds grew explosively during the 1990s, with total assets in America expanding from $1 trillion in 1990 to $7 trillion in 2000. In Britain, investment in unit trusts, the local equivalent of mutual funds, increased from £46 billion in 1990 to £261 billion in 2000.

More than any other financial product, these vehicles have brought shareholder capitalism to the masses. American investors now have over 8,200 mutual funds to choose from, and British ones about 2,000. Half the households in America have money in one or more. Savers in continental Europe, who traditionally kept their money in banks, started buying mutual funds in earnest about ten years ago.

Choosing a mutual fund is one of the most important financial decisions that an individual can make. Over a period of time, the difference between getting a 3% or a 5% annual return from a mutual fund becomes enormous. Sadly, most of what the fund-management industry calls retail investors are quite bad at finding suitable homes for their money. Consider some of the principles of behavioural finance, which studies the way people make financial decisions. To start with, investors are over-confident, and think that they are better at making choices than they really are. They believe in winning streaks and are impressed by short-term success. They confuse familiarity with real knowledge, and over-react to both good and bad news. Worse, most of them are trapped in a cycle of fear and greed. When the market goes up, they are desperate to rake in more than their neighbours. When it falls, they become convinced that it will never recover.

These traits were much in evidence during the 1990s. Greed led people to switch frequently between mutual funds, always seeking out the latest top performer. But that proved to be a mistake, because the hot funds quickly stopped outperforming the rest. Between 1984 and 2002, the return on Standard & Poor's 500 index was 12.9% a year, according to DALBAR, a mutual-fund research firm. Over the same period the average equity mutual fund returned 9.6% a year, calculates John Bogle, the founder of Vanguard, a low-cost mutual-fund company; but the individual investor in equity mutual funds got an annual return of only 2.7%, because of switching. To give an idea of what those numbers mean, $10,000 invested in the S&P 500 in 1984-2002 would have grown to $89,000, but the average mutual-fund investor's $10,000 would have grown to just $16,200. The mutual-fund business may claim to be free of scandal, but, asks Mr Bogle: “Isn't that at least a minor one?”

If there is a scandal in the fund-management business, as some people believe, it is of a subtle kind. As the fund-management business grew, it concentrated increasingly on relative performance. Although the law of averages means that only some people can beat the market—the market being simply the sum of everybody's investment decisions—most fund managers sell the idea that they can outperform the rest. The financial media benefit too, because they get money from advertising and free content from portfolio managers talking about their stock-picks. In a book published last year, “The Great Mutual Fund Trap”, Gregory Baer and Gary Gensler imagine a television interview with a fund manager:

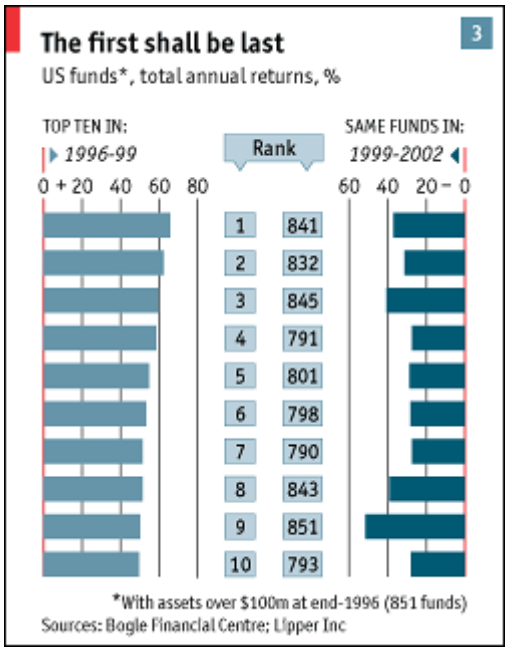
In the real world, few fund managers are subjected to this kind of interview. Indeed, some American financial publications told Messrs Baer and Gensler that they would not write about their book, which argues that Americans are needlessly paying billions to the mutual-fund and brokerage industries. “If it's all a matter of chance,” one journalist explained, “why would anyone read my column?”

In return for the promise to outperform, which mostly turns out to be false, active managers earn a generous fee. Most fund managers actively try to beat indices. Passive managers who simply track the market have captured only a small portion of retail investors' assets. Undoubtedly, a few active

managers do beat the market, and these are worth paying for. The impossible part is knowing which ones will pull it off.

Most fund managers try to convince investors that they will outperform the market by boasting about how well they have done in the past. This seems reasonable enough: in most areas of endeavour, human beings are judged on their track record. But fund managers themselves know quite well that in their industry past performance is no guide to the future. The head of one of the world's biggest mutual-fund companies argues privately that past performance is not only a false guide but if anything a contrary sign. However, few managers would say as much in public, because it would undermine the way in which the industry sells its products.

Numerous empirical studies have confirmed that strong performance by a fund manager seldom lasts. Napoleon is said to have asked his generals before battle: “Are you lucky?” For fund managers, too, much of their performance comes down to luck, not skill, and the luck rarely lasts (see chart 3). If you look at the top-performing fund managers in most asset classes in a recent period, says Roger Urwin of Watson Wyatt, four out of five will be there by chance rather than pure skill.



A fund manager can use a short period of strong returns to suck in lots of new assets to manage, but that can make it even more difficult for him to outperform his peers. The larger the value of a trade in the stockmarket, the more likely he is to move the market against his fund and his investors. The bigger the fund gets, therefore, the worse its performance is likely to be. There is evidence of some correlation between past and future performance, but it is not of a kind to please investors. In a recent study by Britain's Financial Services Authority, two economists, David Blake and Allan Timmermann, found that poor fund managers underperform consistently.

You let us down

Retail investors have lost a lot of money in the past three years, and many of them have called a halt. In America, they pulled $48 billion out of equity mutual funds between June 2002 and April 2003. In continental Europe too they are shifting some of their investments elsewhere. Only in Britain are investors continuing to put more money into such funds than they are pulling out. Much of the money that has been withdrawn has gone into bonds or into the bank. Mutual-fund companies such as Janus and Putnam that sold high-risk technology-stock funds have seen the sharpest falls in their assets.

Some fund managers were unscrupulous in the way they sold their funds. Invesco, an investment bank with a fund-management arm based in London, marketed a fund called the Invesco Perpetual European Growth Fund as a diversified European equity fund. The fund pulled in the most money of any fund in Britain in 2000. Many of the stocks in it were listed on the *Neuer Markt*, the German technology stockmarket which was shut down last year. “It turned out to be a technology fund in drag,” says a fund-management analyst in London. The fund has fallen by 65% since September 2000.

The industry as a whole has done a poor job for investors, says Huw van Steenis, an analyst at Morgan Stanley in London, because it has concentrated too much on selling. In future it needs to give people products that are suitable for their needs, which mostly involves avoiding excessive risks. Some fund managers are privately contrite. “We didn't properly explain risk to the client,” says Hendrik du Toit, chief executive of Investec Asset Management, an Anglo-South African fund-management company. If the industry does not remember its purpose, he says, which is giving ordinary people a dignified retirement and making sure that the rich hold on to their money, its clients will desert it. In the 1990s, says Kevin Parke, president of MFS, America's tenth-largest and oldest mutual-fund company, based in Boston, some people in the fund-management industry forgot that they are fiduciaries, and that the money they manage is not their own. When a portfolio manager at MFS in Boston says, “I own Intel”, or refers to “my fund”, he reminds them that the money actually belongs to the client.

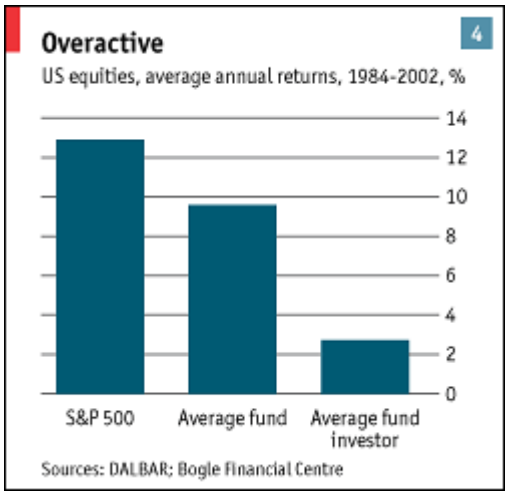
But retail investors have as yet made little complaint. In fact, says Mr Ellis of Greenwich Associates, it is remarkable that companies such as Janus and Putnam could have behaved as they did without provoking

more capital flight. It was only in the fourth quarter of 2001, about 14 months after the American stockmarket started falling, that people began to take their money out of equity mutual funds. It seems that in matters of investment, people are slow and forgiving, says Mr Ellis.

All the investors' fault

It can be argued that during the bull market fund managers did nothing more sinister than meet investors' demands. Simon Davies, chief executive of London-based Threadneedle, caused a stir recently by seeming to suggest that investors should blame their losses on themselves and their greed, not on the fund-management business. He has since softened his tone, but most asset-management bosses would agree with the original interpretation. Because fund management is a fixed-cost business, says Mr Davies, volume is the holy grail, and there is a huge temptation to offer the latest hot product. Some houses warred internally in the 1990s over whether to stick to their investing principles—which include not buying ridiculously overvalued stocks—or to go with the flow and launch technology funds. Fidelity's former chief investment officer, Robert Pozen, resolutely refused to start an internet fund in 1999, thus helping the firm to keep its conservative and reliable image.

At cocktail parties, says Mr Parke, friends would boast to him that their own personal portfolios had done better than his professionally managed funds. “Why aren't any of your funds up 100%?” they would ask. To stay true to their investing discipline, growth managers such as MFS were forced to own overvalued stocks. “The more you worked on analysing the numbers, the worse you performed,” Mr Parke says, “and the more you thought about what you owned in your funds the worse you felt.” Now that the market has returned to its senses, Mr Parke says he enjoys being a fund manager again.



Will the fund-management business keep offering people what they think they want, even when it knows that it is bad for them, or will it behave more responsibly in future? Certainly, fund managers are unlikely to tell their customers one basic truth—that they would be better off if they put more money into passive funds and stopped chasing big active returns. In the ten years to 1999, index funds returned an annual average of 14.7% to their investors and the S&P 500 gave 12.4%, according to Morningstar, a fund-tracking company based in Chicago, whereas actively managed funds returned 10.9%. Those numbers do not take into account the negative effects of switching. Between 1984 and 2002, according to DALBAR's numbers, passive investors got about 13% a year, compared with 2.7% for those who put their money with active fund managers. Not all money can be passive, of course, because if it were, no one would be making intelligent decisions about which companies deserve capital. But at present there is plenty of room for more.

The passive pursuit of profits

If anyone were able to find active managers who could beat the market year in, year out, it would be institutional investors, ie, pension funds and insurance firms. After all, they have teams of people to work on the problem. But the professionals put more money in passive funds and less in active than do retail investors. In America, institutions have 25% of their money in index-trackers, against 12% for individual investors. In Britain the numbers are 20% and 10%, and in continental Europe 5% and 2%. “We all know that on average we don't beat the benchmark,” says a fund manager at a large Swiss bank, “but active management has been our bread and butter.” People fall in love with companies whose products they buy, he says—and they don't want “all the shit in an index”. Yet they may not fully understand the cost of active fund management.

For the moment, the fund-management business is busy devising products to sell in a bear market. So-called stable-value and principal-protection funds are all the rage. These offer investors part of the return from the stockmarket, or from other asset classes, as well as guaranteeing to give back at least the nominal capital the punters have put in. According to Lipper, an American fund-tracking company, assets in stable-value funds have risen from $264m to $3.3 billion since the beginning of the bear market, and money in principal-protection funds has grown from $724m to $5.6 billion. They do not come cheap; an investor can pay up to 5.75% of the initial investment in what is known as an “up-front load”.

Some fund managers suspect that rushing out with capital-protection products is not much different from pushing out a new technology fund regardless of whether or not it will make money for customers. Investors could get the same combination of capital protection and investment return more cheaply using simple asset allocation, says Edward Bonham Carter, joint group chief executive of Jupiter Asset Management in London. MFS has decided not to launch principal-protected products, says Mr Parke, who considers the willingness to say no to certain products a strategic strength. The National Association of Securities Dealers has given warning of principal-protection funds' high fees, long mandatory holding periods and possibly low long-term capital gains.

Steven Niemczyk, an investment banker at Morgan Stanley in New York, sees no evidence that retail investors are overtly unhappy with the industry, but he says there could be a latent demand for a better product. People were quite happy buying gas-guzzling American cars in the 1970s, he points out, until Japanese manufacturers offered a superior product. Mr Niemczyk dreams about a new fund-management product customised to the needs of individual clients. It would use sophisticated computer techniques now available to give better risk-adjusted returns. A fund manager with the skills to develop such a product and the courage to invest in it, he says, could transform the industry. For now, though, most fund managers are too busy dealing with today's crises to think up radical ideas for the future.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Down to business

Jul 3rd 2003
From The Economist print edition

The fund-management industry needs to adapt to harder times, but its long-term future seems secure

TO OUTPERFORM the market, says a British fund manager, you need to be a bit of a loner. The best fund managers are arrogant, competitive and cocksure, and they rarely set much store by other people's opinions. “This is a list of attributes for people who should not be allowed to manage others,” he says. But it is exactly these sorts of personalities that end up at the top of fund-management firms. It is perhaps not all that surprising, therefore, that many of these firms are not particularly well run.

Up to now, poor management did not matter too much, because revenues were flooding in and everyone was making a lot of money. Unlike other industries, such as cars and steel, the fund-management business did not have to become efficient—partly because, although it appears to be all about numbers, people matter so much. For example, one large fund-management firm in London would try to generate goodwill by inviting pension-fund trustees to London to stay in a penthouse flat overlooking the Thames. “The American clients liked it the most,” says a former employee, “and we rarely lost one, despite underperformance.”

Naturally, some fund-management businesses are far more efficient than others, and the good ones are still making money even in the present harsh environment. But in firms that have cost bases significantly higher than similarly sized competitors, “we need to see a much higher standard of professional management”, says Andrew Doman, head of the asset-management practice at McKinsey, a management consultancy.

A large chunk of the industry, indeed, is a product of the long bull market. In both America and Britain, roughly 80% of the money now invested in mutual funds came in during the 1990s. Barriers to entry for the money-management industry, after all, are low. You do not need much capital, because in one sense the product—investment return—already exists out there, in the form of the financial markets. But now the fund-management industry as a whole will have to rationalise, and individual firms will need to make sure that their business is diversified among different forms of investment.

For the people who work in these companies, this is coming as a shock. Most of the developed world's wealth is managed by people too young to have any experience of serious economic difficulty. “Our research analysts are still putting normal growth rates into their models and finding that they are completely wrong,” says a fund manager in London. Now people are getting bad-tempered. “Everyone has sat on top of a stock that has been creamed, and even good people are getting fired.”

Average revenues at European fund managers fell by a quarter in 2002, according to McKinsey, and are heading further down this year, for three reasons. First, the value of assets under management has fallen with the markets, thus reducing fund managers' percentage fee in absolute terms. Second, investors have taken money out, again reducing the volume of assets under management. Third, some of the assets that remain have been moved out of equities and into bonds. In the institutional business, a fund manager typically makes about 25 basis points (hundredths of a percentage point) on equities but only 10-12 basis points on bonds. And on the retail side, the drop in margin is almost as bad: managing equities for individuals yields about 250 basis points, whereas running bonds earns 150 basis points. Costs have not fallen in tandem, so profits dropped by almost half last year.

Watch those margins

Fund managers can expect their margins to fall further, and not only because of a shift from equities to bonds. Stockmarket returns in the developed world over the next few years seem likely to be less munificent than in the 1990s. Suppose they give a real return of 5% a year over the next five years,

compared with 15% from the S&P 500 in 1990-2000. That would make fund-management fees of 1-3% loom proportionately a lot larger. Industry executives reckon that retail investors will pay more attention to fund-management fees in the coming years, and margins will have to come down.

Costs at fund-management firms have not fallen much. Typically, over half of a fund management firm's cost base consists of salaries. Fund managers used to be paid far less than the stockbrokers that serve them, but the difference narrowed during the 1990s. However, straightforward salaries (rather than bonuses) make up a larger proportion of the pay packet than they do, say, in investment banks, so it is harder to cut the pay bill quickly. So far, fund-management companies in America and Britain have cut 10-15% of their staff, but they need to do more. In continental Europe they are further behind.

When more of them get round to it, they may run into difficulties with their most important clients, the pension-fund consultants. The consultants worry that a firm's investment performance will be spoilt when it starts firing people. They may have a point; the only meaningful correlation between a fund-management business's corporate characteristics and its investment performance, says a London-based fund manager, concerns the morale of its portfolio managers. “Once you lose the confidence to invest,” he says, “you never get it back.”

Because so far the fund-management industry has been in the habit of adding costs—revenues were soaring, after all—it is not sure what it can safely cut. One fund-management firm in London, for instance, has imposed an informal travel ban. This contradicts the firm's marketing material, which says that its fund managers make lots of visits to companies each year. But such visits do not translate into better investment performance anyway, says one of its employees; they were only ever a piece of selling, and lots of company visits were often squeezed in on the last day of the financial year.

Piggy in the middle

Medium-sized fund managers will find themselves in the trickiest spot. At the moment, says Mr Doman, managers with $50 billion-100 billion of assets under management are the least profitable. They find it hard to pay for a global presence and a broad range of investment products while still producing a good return. By contrast, big managers can afford these things even in a bear market, and boutique investment firms are at least cheap to run.

A looming challenge for mid-sized outfits in Britain will be the phasing out of “softing” in response to regulators' concerns. In America too, Mr Baker has asked the SEC to look at the practice. In softing arrangements, investment banks provide fund managers with research and other services in return for an agreed volume of trading commission. The biggest fund managers already do much of their own research, says Mr Bateman at Fidelity International. But medium-sized firms rely more on outside research analysts, and will face a new cost once softing recedes.

The answer for medium-sized firms is either to get bigger quickly or to join forces with others. Large financial institutions that bought fund managers during the 1990s would like to sell them; at least six European insurance companies would be pleased to get out of the business right now, says a consultant who knows their managements well. To make matters worse, owners may face a tough new rule from the Bank for International Settlements on capital adequacy for asset managers. European fund managers fear that the new Basel Capital Accord, which will come into effect in 2006, may insist that they keep more capital on hand than they do at present, which would reduce their return on equity. AMVESCAP, a British fund manager with most of its business in America, recently said it would de-list from the London Stock Exchange if that happened.

For the moment, though, consolidation is on hold because sellers cannot bring themselves to strike deals at prices far lower than those they paid. In 1999, for instance, Prudential, a British insurer, bought M&G Group, a unit-trust manager, for £1.9 billion, the equivalent of about 10% of M&G'S assets under management. At the end of last year, Rothschild sold its loss-making asset-management business to HBOS, a British bank, for the equivalent of just 0.6% of its assets under management. At such low valuations, sellers would have to write off substantial amounts.

A sign that realism about price is setting in, executives say, is that private-equity firms are sniffing around. Private-equity investors look for high returns, so these firms cannot be planning to spend much. They will be hoping to buy a few medium-sized asset managers and weld them together. However, the investment processes of the constituent firms may not be readily compatible. One powerful pension-fund consultant has spoken out against consolidation in the industry. Roger Urwin at Watson Wyatt, Britain's

largest firm of actuaries and investment consultants, said earlier this year that it would not be putting merged asset managers on its recommended lists.

In spite of all the gloom, the business of fund management remains attractive; it simply needs to be run in a disciplined way, just like other industries. The long-term case for optimism—that the populations of the rich world are ageing and demand for savings products is bound to rise—still holds true. Governments are trying to get individuals to fund their own retirements, meaning that in future pensions will be provided by the fund-management industry rather than by the public purse. In Europe, the pay-as-you-go retirement system, in which contributions from younger workers pay for the pensions of older ones, is under severe strain. Pension reform in Europe, when it eventually comes, will boost fund managers.

But before then, consolidation, however hard to bring off, is necessary and inevitable**,** because so many fund managers are currently unprofitable. “We are in the midst of a purifying process,” says Gabriel Herrera of UBS. “Eliminating those who did not do a professional job will be good for the client and for the industry as a whole.” Fund management is not the easy and hugely profitable business it once was, but nor has its time passed along with the bull market.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Ogling Bogle

Jul 3rd 2003
From The Economist print edition

His peers cannot ignore the industry's enfant terrible

“IT IS not ludicrous to liken old Bogle to Moses bringing the law down off Sinai amidst thunder, lightning and a thick cloud,” wrote a customer of Vanguard, a low-cost mutual fund company, about its founder, John Bogle. Mr Bogle started Vanguard in 1974 on a mission to lower the cost of fund management. One thing that marks it out from other mutual-fund companies is that the entity distributing its funds is owned by its shareholders. Vanguard's overheads on the $550 billion of assets it has under management averaged 26 basis points last year, against an industry average of 136 basis points.

Part of the reason that Vanguard is so cheap to run is that about one-third of its assets are passive and simply track indices. But even where Vanguard invests actively, its costs are still far lower than those of its competitors. Despite its refusal to spend much money on marketing, Vanguard has grown into the second-largest mutual-fund manager in the world, just behind Fidelity.

Mr Bogle stopped running Vanguard in 1999; he is now 74 and had a heart transplant in 1996. These days he spends his time criticising the rest of the mutual-fund business. It no longer puts the interests of its investors first, he says, but exploits their ignorance to charge too much. It cares more about is marketing and distribution than its investment return.

It is hard to quarrel with Mr Bogle's numbers. Despite the massive expansion of the mutual-fund business—assets increased 114-fold in 1978-2002, from $56 billion to $6.4 trillion—the expense ratio of the average mutual fund over the same period increased by half, he says, from 0.91% to 1.36%. Such economies of scale as may have been reaped have certainly not all been passed on to fund investors.

Another favourite fact of Mr Bogle's is that mutual-fund turnover has increased from 16% four decades ago to 110%, meaning that the average fund holds a stock for just 11 months. If the transaction costs of this high turnover—market impact and the bid-offer spread—were made explicit, Mr Bogle says, investors would see that the cost of fund management eats up as much as 2.5-3% of their assets a year.

Suck it and see

If the fund-management business has an idea for a product, the new fund is out on the market before anyone has tested it. This way of developing new products by trial and error makes the fund-management business unique among big industries. Many of the products do not make money for investors and are quietly withdrawn. Over half of the funds that American mutual-fund companies started up during the 1990s no longer exist today, according to Mr Bogle, and 900 funds failed in the past three years alone.

“What Bogle says makes us all squirm,” says the head of a big mutual-fund company. The industry has fought back, claiming that Mr Bogle's attacks on their profits make him sound like an enemy of capitalism. “People inside Vanguard don't necessarily agree with him,” says a consultant to the industry in Boston. “They think that something is due to the firm's employees as well as to its shareholders.”

Mr Bogle's detractors may call him bolshevik, but his remedies are far from extreme. He wants more and clearer disclosure of costs from fund companies, so that investors can see for themselves what sort of deal they are getting. He also wants a new law to make the chairman of a mutual-fund board of directors independent of the managing company. But Mr Bogle has landed so many punches on his own industry that he is now ostracised. “Would you have him to dinner?” asks a mutual-fund chief. “Probably not.”

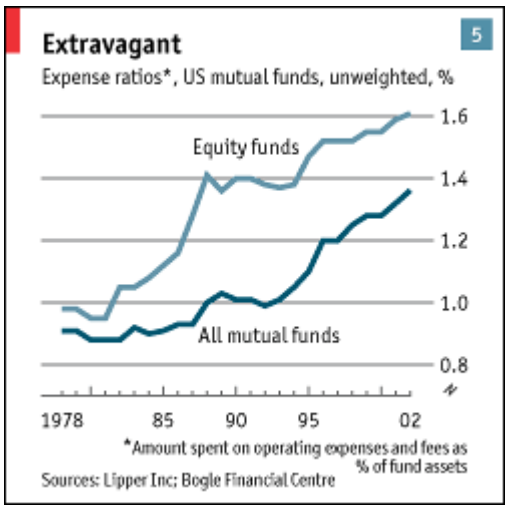
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Tell us more

Jul 3rd 2003
From The Economist print edition

Regulators want fund managers to become much more open about the way they run their businesses



BECAUSE investors have lost so much money, the fund-management industry is coming in for much closer scrutiny from regulators and politicians than it used to. At the end of last year, the SEC, which regulates the industry in America, pushed through a new rule that will force fund-management companies to show how they use their power over the companies they invest in. From next summer, the new law will require them to reveal how they have voted on proxy proposals. And in June, Richard Baker, chairman of a congressional subcommittee on capital markets, insurance and government-sponsored enterprises, announced legislation that would impose onerous new requirements on the industry.

Mr Baker's proposed new law originated at a hearing in March on mutual-fund industry practices and their effects on investors. Some well-known critics of the industry, such as John Bogle of Vanguard and Gary Gensler, a former under-secretary of the Treasury, testified before the committee, and others were on hand to defend it. Mr Baker asked the SEC to look into a number of practices that he believes may be damaging to investors. On the basis of the SEC's report, his bill would require mutual-fund companies to publish new information about the costs they take out of people's savings. Operating expenses should be shown in dollar terms, it says, not just in percentages, and portfolio transaction costs must be published in a way that allows investors to compare their fund manager with others.

Just as the Sarbanes-Oxley act dealt with corporate governance last year, Mr Baker's bill would strengthen the governance of mutual funds. As things stand, an investor might assume that a Fidelity mutual fund, for example, is under the control of Fidelity. In fact, the fund is quite separate from the portfolio managers who invest its money. It is controlled by mutual-fund board directors, a majority of whom must be independent of the fund-management company. Their main job is to choose a manager for the fund and negotiate fees, always putting the interests of the fund investors first, in line with the 1940 Investment Company Act. In practice, though, the management company hires board directors who often behave as though they were its employees, and seldom conduct themselves as active champions of fund investors.

Diseconomies of scale

According to the SEC's report, published in June, fees for actively managed funds have risen over time, even though the many new entrants should have increased competition and the large inflow of money into the industry should have produced economies of scale. Fund-management companies in America on average charge 70% more to manage a mutual fund's money than they do a pension fund's, according to Morningstar, the Chicago fund-tracking company. One reason could be that mutual-fund directors have neglected their duty to the investors and, having been hired by the management company, have little incentive to reduce fees. A 1996 study by Morningstar found that where mutual-fund directors were paid particularly generously by a fund-management company, the fees charged to investors were especially high.

Warren Buffett, a famous investor and chairman of Berkshire Hathaway, an investment company, recently joined the critics of mutual-fund governance. In his company's annual report for 2002, he wrote that: “For the most part, a monkey will type out a Shakespeare play before an ‘independent' mutual-fund

director will suggest that his fund look at other managers, even if the incumbent manager has persistently delivered substandard performance.” Each year, he said, “the directors of fund A select manager A, fund B directors select manager B, etc, in a zombie-like process that makes a mockery of stewardship.” In negotiating management fees for funds, he added, mutual-fund directors have also failed miserably. Mr Baker's bill would require two-thirds of all board directors to be independent, up from a majority now, and would tighten the definition of independence. It also wants the chairman of the fund's board to be independent, which at the moment he does not have to be.

Mr Baker's new bill has also shone a light on another practice—fund distribution—that the industry would prefer to keep in the dark. The industry pays large sums of money to get so-called “shelf-space” with the brokers through which most people buy mutual funds, to encourage them to recommend one product rather than another. The fund managers take these fees straight out of investors' money, directly or indirectly. They argue that good distribution means more assets under management, which in turn means economies of scale for fund shareholders.

As the SEC pointed out, though, fees have risen at the same time as assets under management have grown. Mr Baker's bill calls for disclosures about distribution deals with brokers, so that investors can see how much of their money is being spent on something that boosts the fund company but not necessarily its investment performance.

The mutual-fund industry is furious to find itself thus targeted. Its leaders say it is already highly regulated. David Weinstein, head of government matters for Fidelity, says the firm's office in Covington, Kentucky, receives thousands of envelopes with big cheques from investors inside. They feel safe sending their money, he says, because the business is ruled by the 1940 act. “We've been very humble as an industry,” says Mr Weinstein. “We need to start getting our message out.”

The industry's defence is that performance is shown net of all costs, both the visible and the hidden kind. And if investors are unhappy with the return they get after all costs have been deducted, they can always vote with their chequebooks. In a submission to Mr Baker's committee, Fidelity wrote that investors in America can choose between 8,000 mutual funds offered by over 600 companies, and are “fully informed and free”. The industry will lobby hard against Mr Baker's law, and may succeed in watering it down.

In Britain, meanwhile, the Treasury has started evaluating the impact of the Myners report, which criticised the fund-management industry and made recommendations for change. One of the most important of these is that pension-fund trustees must become more professional in their relations with fund managers. They should be legally required to familiarise themselves with investment issues, and to set an investment objective for their funds. The fees they pay to fund managers should include the cost of services such as research and newswires that are currently covered by softing arrangements. Fund managers must also start using their power to improve corporate governance at the companies whose shares they own. For the moment, the Myners recommendations are voluntary, but the Treasury says it will consider legislating if the industry proves unresponsive.

Getting pension-fund trustees to do their job properly is essential. On the retail side, the most useful change that regulators and lawmakers could make would be to force the fund-management industry to be more open about its costs, including transaction charges. Many people do not understand how percentage rates eat into their money. Mr Baker's recommendation that costs be shown in dollar terms would give them a much clearer idea.

Truth in advertising

Regulators should also make sure that mutual-fund companies do not bury important information in obscure places, or present it selectively so that investors might be misled. For example, Strong Financial, a mutual-fund company based in Wisconsin, advertised one of its technology funds in 2000 by stating that it had risen by 147.8% over one year, followed by “Any questions?” The Financial Services Authority, which regulates the industry in Britain, recently ruled that fund managers must show standardised past performance numbers, not just cherry-pick flattering periods.

Many people pay a lot of money for active management because they want to beat the market; and if they manage to pick the right fund, the fees are indeed dwarfed by the additional return. But the industry should be strongly encouraged to be more honest in its marketing, and to make sure that investors know how much their flutter is really costing them.

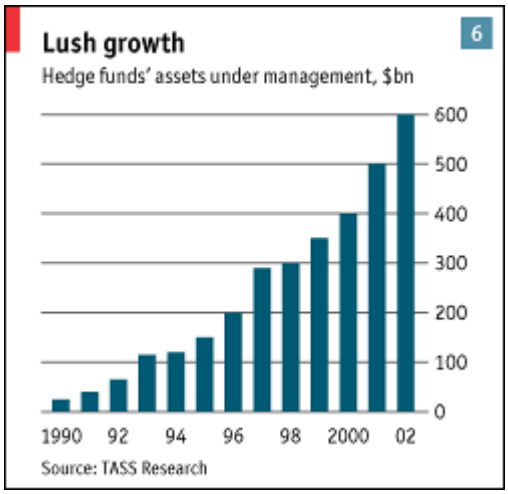
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

For the fortunate few

Jul 3rd 2003
From The Economist print edition

Hedge funds attract the most talented managers, but their capacity is strictly limited



IF YOU were that rare creature, a fund manager gifted enough to beat the market consistently, would you stay with a large fund-management firm? Your alternative would be to take yourself off to a hedge fund, where you would get one-fifth of your fund's return on top of a steady management fee. As well as earning a lot more cash, hedge-fund managers enjoy the ability to invest as they please, with no need to hug an index, and freedom from organisational bureaucracy.

Many of the best fund managers left the conventional industry during the 1990s to set up hedge funds. These people have started an estimated 3,000 new hedge-fund-management firms since 1990, according to TASS Research, a hedge-fund researcher. They manage a total of $600 billion, up from $300 billion in 1998 and $120 billion in 1994. In the area around St James's Street in London, a place some way from the City, so many hedge funds have set up shop that it has become a financial centre to rival Frankfurt as measured by assets under management. But with the increase in assets has come attention from regulators.

Hedge funds are attractive for a variety of reasons, including their ability to get round some of the shortcomings of the conventional fund-management business. They can short shares, meaning they sell them and buy them back later, with luck at a lower price, so they can make money in falling markets; and they use leverage to profit from small pricing anomalies. Hedge-fund managers put their own savings into their fund, so their interests are aligned with those of their investors. In most cases, the managers get their one-fifth share only if they beat a performance target. Wise hedge-fund managers carefully limit the amount of money they take in. That allows them to stay nimble and avoid moving the market against themselves too much.

Hedge funds make “absolute” returns, not measuring themselves against an index but aiming simply to make money. The conventional fund-management business, on the other hand, measures its performance on a relative basis. Instead of taking a long position in shares that will probably fall, just because the company has a big weighting in an index, a hedge fund can short them. For most savers, however, hedge funds are out of reach, because they cater only for clients who have upwards of $1m to invest.

Absolute preference

Pension funds too are now asking their conventional managers to keep more of an eye on absolute return. During a bull market, when everything is going up, it makes some sense to measure active performance against a benchmark. During the 1990s, fund managers stuck closer and closer to their benchmarks, afraid that if they strayed from them and something went wrong, they would have assets taken away from them. Investors were paying active fees but getting passive performance. In April, Mercer Investment Consulting asked 300 pension funds and investment managers in London whether benchmark-hugging was a problem; 89% said yes.

Pension funds are also planning to move a lot more money into hedge funds. According to a study earlier this year by Greenwich Associates, about one-third of institutional investors in America plan to increase their allocation to such funds. University endowments have led the way—Yale University has a quarter of its endowment money in hedge funds and Harvard University also likes them. “Harvard, Princeton and

Yale have made it legitimate for others," says Samuel Hayes, a professor at Harvard Business School. Swarthmore, a college in Philadelphia with $1 billion to invest, is currently testing a hedge-fund programme. CalPERS, the world's largest pension fund, with $130 billion under management, is thinking about lifting its allocation to hedge funds from its present $1 billion.

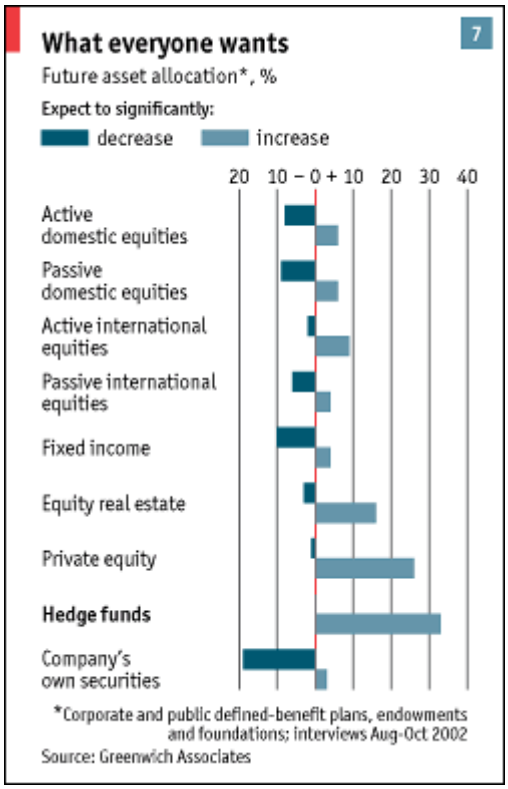
Stampeding into hedge funds cannot, however, be the answer to pension funds' woes. There is simply not enough room for a lot of money in hedge funds, or at least not in good ones. The 100 biggest pension funds in Britain have about £400 billion to invest, and if they allocated, say, 20-30% to hedge funds—against less than 5% at present—it would create a wall of money. Already, says Nathan Gelber of Stamford Associates, some may be rushing in too quickly. One pension fund asked Mr Gelber to put $500m into hedge funds. He explained that to do it properly would take three years—a year for the first $200m and another two for the rest. Impatient, the fund went elsewhere.

The exclusivity of hedge funds, indeed, points to the wider difficulty faced by most of the world's investors. According to Frederick Sheehan, director of John Hancock Financial Services in Boston, asset management for the masses is a problem in itself. Only a few people are capable of producing exceptional investment returns, and that kind of investment, Mr Sheehan wrote in a recent article, "is not an off-the-shelf product." For the majority of investors, outstanding returns are out of reach. The very best money managers in the world run hedge funds, and these cater only for the rich. Many of the best hedge funds are closed even to pension funds. Roughly a third of the capacity of the 2,314 hedge funds on TASS's database, weighted by assets, is shut to new investment.

An expensive back door

A popular way to gain access to hedge funds these days, both for institutional and retail investors, is through a fund of funds. A fund-of-funds manager typically puts between five and 20 hedge funds, sometimes more, into a basket. The idea is to get high hedge-fund returns, but with less risk of the manager losing the money on some bizarre trade, or running off with it, as a few have done. Some fund-of-funds companies go to great lengths to gauge the characters of hedge-fund managers. One asked a hedge fund in America if it would mind having a private investigator put on its traders for a couple of weeks. The request was turned down. Other funds of funds, says another hedge-fund manager, do not even bother to ask permission.

Still, funds of funds get caught out. When Beacon Hill, a Boston-based hedge fund, went under, says a fund-of-funds manager, "it amazed us how many funds of funds were invested in it." The fund of funds run by Morgan Stanley, she adds, managed to invest in two big recent hedge-fund debacles—Beacon Hill and Lancer Partners, a now-bankrupt hedge fund in New York.



On top of the already high fees charged by a hedge fund—a fifth of the investment return plus a management fee of 1-2%—a fund of funds takes another slice, typically 10% of the return if the fund does well, plus a fee of around 1%. Some people question whether funds of funds will be able to keep taking this extra slice unless hedge funds make higher returns soon. The CSFB/Tremont hedge-fund index, a widely used indicator, returned just 3% in 2002, and half of the various strategies—long/short equity, convertible arbitrage and so on—made less than 5%. Funds of funds face particular difficulties getting into the best hedge funds. Managers want money in big chunks, and from people who will not take it away at a critical point. On these criteria, funds of funds do not rank highly.

Some conventional fund managers see hedge funds as a threat. The head of one firm complains that these funds have an unhealthy relationship with Wall Street; because investment banks put them in business as their prime brokers, he says, they get the first call with new information. And if hedge funds go downmarket and start taking in money from retail investors, says John Brennan, chairman of Vanguard, they should be regulated. "If it's going to be a $1 trillion industry," he says, "why leave it outside the regulatory framework?" Yet as the boss of a fund-management company in London points out, technology funds

were fully regulated and investors still lost plenty of money.

Other conventional managers are rushing to start their own hedge funds. For example, Gartmore, a British fund manager with $45 billion in assets, has started 18 hedge funds in the past four years. Its chief executive, Glyn Jones, say it has done this to meet the demand for absolute return and to attract and retain the best talent. Other relative-return asset managers have bought alternative-asset firms. In 1999, UBS, for instance, bought GAM, which runs funds of funds.

Putting hedge-fund products under the same roof as conventional, long-only offerings can create conflicts. Already, some insurance companies have stopped the practice of lending their securities out so that hedge funds can short them; the insurance company, after all, wants the shares to go up. Similarly, a fund-management house could be embarrassed if shares in its long-only, retail business were being torpedoed by hedge funds shorting them on behalf of the fund firm's rich customers.

Hedge-fund managers reckon that their conventional cousins' attachment to relative return will have to be jettisoned if the bear market continues. “Absolute return is where all fund management came from,” says Willie Phillips, a former investment banker who recently set up a hedge fund in London. Already, some are thinking about absolute-return products. Jupiter is looking at absolute-return funds with performance fees, in which it would take some control of asset allocation. The funds would have those hedge-fund characteristics, says Mr Bonham Carter, but would not go short or use leverage.

Mostly, though, relative thinking remains entrenched. Consider the Odey Continental European Trust, a British unit trust run by Hugh Hendry, who is also a hedge-fund manager. Earlier this year, Mr Hendry put a third of the unit trust's money in German bonds because at that point he could not find many stocks that were going up. But according to the Investment Management Association, the British fund-management industry's trade body, an equity unit trust has to have 80% in equities. Although Mr Hendry's asset class—European stocks, excluding British—was down by 27% in 2002, his fund was up by 3%. But the IMA has insisted that he go back into equities or sacrifice the fund's status as a unit trust. “I have a lot of happy investors,” says Mr Hendry, “but according to the IMA I am a bad boy.”

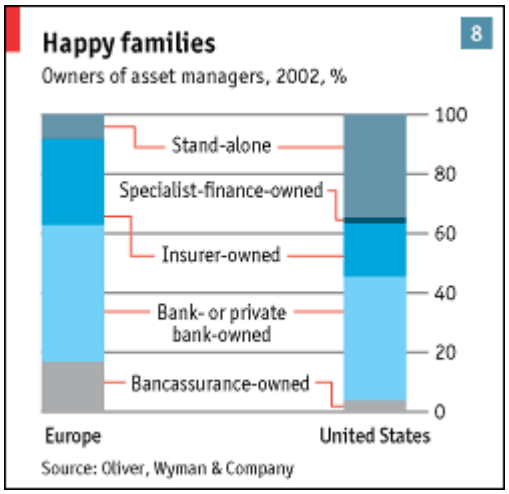
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Cutting their cloth

Jul 3rd 2003
From The Economist print edition

Hard times are forcing fund managers to change their ways. But for how long?



CONVENTIONAL active fund managers believe in what they do because they have to: their livelihood depends on the notion that they can find investing opportunities which the rest of the market has overlooked. So they determinedly ignore the fact that most of them underperform market indices, and that investors would be better off putting more of their money into passive funds. These people will not suddenly agree that there are too many mediocre fund managers in the world and the industry needs to downsize. Thoughtful people in the business, however, are now quietly worrying about how it adds value. Pension funds realise they need to rethink the way they have been investing money. The chances are that, for a while, asset-management companies will abandon some of their worst habits.

Slowly but surely, fund managers will stop hugging benchmarks quite so closely. Currently, a typical fund manager with a mandate to buy, say, British equities will be told to aim at a performance that strays no more than 3% away from the benchmark. That means fund managers will generally hold no less than 75% and no more than 125% of a stock's weighting in an index. In future, pension funds will increasingly divide their money between passive fund managers and active ones that live up to the name. Investing will become polarised between huge, global and cheap index-trackers on one hand and truly active ("specialist") managers and hedge funds on the other. The closet index-trackers in the middle will lose out.

Specialist active managers will invest with a close eye on absolute returns. They will care about making money, not just out- or underperforming an index. If this happens on a large scale, allocation of capital will improve. Portfolio managers will put money with companies that they think will make the most of the capital, instead of investing in stocks just because they make up a large part of an index. That will make it safer for investors to hand their money to a cheap passive manager. Indices will include fewer duff companies because many of them will have been weeded out by truly active fund managers.

At the same time, fund managers will regain some of their role in asset allocation. A 1986 study by Gary Brinson, an American money manager, found that over 90% of investment return comes from choosing between stocks, bonds and other asset classes. In the 1990s, investors forgot about asset allocation because stocks were outperforming everything else. To use asset allocation, though, fund managers and their clients will have to become less fixated on relative returns. Going overweight in equities and underweight in bonds now, for instance, might produce the right result in the end, but could first lead to years of embarrassing underperformance.

Size matters

The success of specialist active managers should make the fund-management industry ponder a broader question: are superior investment returns most easily produced inside a large, industrial-scale organisation or in an entrepreneurial boutique? The industry's history, and the success of hedge funds, strongly suggest that fund management is best done by smallish groups of people, and with modest sums of assets under management. Countering this is the industry's pressing business need to consolidate and weld together lumps of assets. The challenge will be to find a way to combine size and economies of scale with the sort of entrepreneurial atmosphere that produces good investment returns. Very few fund managers have achieved this. One that has come close, people in the industry say, is Capital Group in California, which despite its size puts investment returns ahead of asset-gathering or

marketing.

In reality, many fund-management firms these days are just a small part of some universal bank. This can lead to conflicts of interest. In the run-up to Hewlett-Packard's merger with Compaq in 2002, Carly Fiorina, Hewlett-Packard's chief executive, told Deutsche Asset Management, part of Deutsche Bank, that a vote for the merger was “of great importance to our ongoing relationship”. The fund manager voted in favour, days after Deutsche Bank had signed a $4 billion revolving-credit facility for Hewlett-Packard to pay for the merger. One pension-fund consultant in London is so convinced of the need for fund managers to be completely independent that it does not recommend any which are part of a larger organisation.

One positive sign is that the fund-management industry appears to be taking a new interest in corporate governance. Before the collapse of the bull market, most pension funds and fund-management companies acted as temporary holders of share certificates, not as owners. They voted mostly with management, and if problems arose they sold the shares.

Part of the reason is that the top echelons of fund managers and large companies rely on each other. A chief executive whose pay deal has been voted down, for instance, can easily take the company's pension plan away from a fund manager. “Tesco is one of my clients,” says the head of a fund-management firm in London. “If I stood up at their annual general meeting and made a fuss as an investor they would take their business away.”

Britain's National Association of Pension Funds recently attacked the pay package of Michael Dobson, the chief executive of Schroders, a large British fund manager, because it included a non-performance-related bonus of £1.8m a year and a termination clause worth a minimum of £3.5m. Mr Dobson and his fellow fund-management bosses might feel uncomfortable if their funds started attacking executive pay in the companies they invest in.

For the moment, British institutions are leading the way in shareholder activism. They have kicked out some chief executives and curbed the pay packages of others. In America, a handful of public-sector pension funds, such as CalPERS, have been active shareholders for years. Mutual funds, though, vote with management most of the time. Starting from 2004, the SEC ruled last year, they will have to disclose the way they vote on proxy proposals. The industry fought hard against this. “The idea that mutual-fund shareholders are interested in how we vote is misguided,” says Fidelity's David Weinstein. He argues that people invest in mutual funds because they want the best financial returns. However, the SEC hopes that the disclosure requirement will embarrass mutual funds into voting for the benefit of their shareholders.

Some hope

Confronted with a radically altered business environment, says an investment banker in New York who specialises in fund management, most American fund-management companies are still relying on hope as a strategy. They cling to the idea that all the troubles in their industry are cyclical, and that markets will revert to the mean. But others believe that some of what is happening may be structural. They worry, for instance, that neither pension plans nor retail investors will put as much of their money in equities or in active fund management in future as they did in the past. That would mean consistently lower profits for fund managers.

During the 1990s, the clarion call for equities was summed up by the title of a book by Jeremy Siegel, “Stocks for the Long Run”. In the long run, Mr Siegel argued, American equities have outperformed bonds, and as long as an investor's time horizon is long enough, it matters not if the stockmarket plummets in the interim.

It may be true that in the past stocks have outperformed bonds in the long run, at least in the two stockmarkets—America's and Britain's—that have survived for long enough to yield sufficient data. But that measurement ignores one vital fact, says Zvi Bodie, professor of finance at Boston University. To make a proper judgment of the risk of putting money into equities rather than bonds, argues Mr Bodie, an investor must consider not just the chances of getting a worse return from shares than from bonds, but also the potential severity of the underperformance. Put simply, the idea of stocks for the long run ignores the possibility that when the stockmarket falls, it may fall so steeply that it wipes out a huge chunk of an investor's savings and leaves him insufficient time to build them up again for retirement.

Far more than risk-averse Europeans, says Chris Brown, a consultant at Financial Research Corporation in Boston, “Americans love performance.” This will keep them in equities and in active fund management, he reckons, despite the dangers of both. What no one can yet predict, however, is the long-term effect of the shift from defined-benefit to defined-contribution pension plans. In the past, employers made a retirement promise to their workers and shouldered the risk that investment returns might not meet it. Now that accounting rules are forcing them to face up to the risk, they are passing the burden on to individuals. Governments, too, increasingly want people to take responsibility for their own retirement income.

When individuals find that they themselves, rather than their employer or the state, are responsible for paying for a retirement of possibly 25 years or more, how will they invest their money? Far more conservatively than in the past, think many fund managers. If getting their investment policy wrong could mean having to work for another ten years, says David Salisbury, formerly chief executive of Schroders and now chief executive of the London subsidiary of Dimensional Fund Advisors, people will not make big bets. Instead, he says, they will take a more cautious approach to investing, matching assets and liabilities more carefully and probably putting more money into bonds than they have done in the past 25 years.

Indeed, if they wanted to, savers could drive a revolution in fund management. They could start demanding value from the business in the same way that consumers have done from makers of everyday products. If they do, the mainstream fund-management business may have to survive on a percentage fee of 1% or less, not the 2-3% it exacts now. Vanguard is still getting strong positive inflows from retail investors into its funds at the moment—the Vanguard 500 Index Fund charges just 0.18%—whereas many active managers are losing clients hand over fist. Pension funds too have put a lot more money into passive strategies of late.

For a while, the fund-management industry seems likely to behave more responsibly. It will go easy on its marketing promises, and it will talk a lot about putting investors first. But when the next bull market comes along, people will fall for another investing fad, and the industry will rise to the occasion. Ultimately, it is up to the industry's customers to do their sums, and insist on a better product.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Acknowledgments

Jul 3rd 2003
From The Economist print edition

The author is grateful to the many people who helped in the preparation of this survey. Particular thanks go to Nathan Gelber, David Salisbury and Huw van Steenis.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Jul 3rd 2003
From The Economist print edition

Reprints

Reprints are available should you wish to order extra copies of the survey. Please send your request to the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

North America:

Rights and Syndication Department
111 West 57th Street
New York
NY 10019
USA

Tel: +1 212 541 0532
Fax: +1 212 641 9808
E-mail:usrights@economist.com

Corporate offers and customised reprints

For corporate reprint orders of 500 or more and customisation options, please contact the Rights and Syndication Department in the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Luxury goods

When profits go out of fashion

Jul 3rd 2003
From The Economist print edition

AP

Things are not looking pretty in the luxury-goods industry

THE worst three months he can remember. That is how Domenico De Sole, boss of Gucci, recently described conditions in the luxury-goods business. “It was the story of ‘The Perfect Storm'. Everything that could go wrong did go wrong.”

On July 2nd, Gucci reported an operating loss for the three months to April. Switzerland's Richemont recently gave warning that, after a one-fifth fall in profits in the year to March, sales in April and May had fallen by over 20%. The auditing firm KPMG recently refused to certify the accounts of the parent of Cerruti, an Italian label, due to mounting losses and crippling debts. In June, Versace reported a swing into losses. Only LVMH has reported decent results of late—thanks to its Louis Vuitton brand, which got a boost from a big new store in Tokyo.

In part, these results reflect the fashion industry's exposure to this spring's three big economic shocks: SARS, the war in Iraq and the rise of the euro against the dollar. Whereas firms in most industries have been using these merely to excuse poor results, fashion really is dependent on tourism, particularly by rich Asians coming to Europe. Revenues from exports are mostly in dollars and yen, and are thus sharply down in euro terms; while costs remain primarily in euros, as luxury goods are mostly manufactured in Europe.

Add also the impact of the long world economic slowdown, to which the once recession-proof industry is more exposed than before due to the strategy enthusiastically pursued by the leading firms in recent years. The really big question is whether luxury's problems are the result only of these recent shocks, plus the slowdown—or if the strategy is failing, too.

Traditionally, the excesses of their colourful owners were a bigger risk to fashion firms than the economic cycle. Most customers were too wealthy to let such trivialities as recession influence their spending. But professional executives such as Mr De Sole, a lawyer by training, are replacing the former entrepreneurs and family managers, and have quite deliberately taken their companies into the mass, or at least the “mass-affluent”, market.

Luxury for the people

In the past decade, thanks not least to the stockmarket bubble, Gucci sunglasses, Prada handbags and Louis Vuitton suitcases became must-have items for many thousands of middle-class buyers. At the same time, the new bosses have built, largely through acquisition, luxury conglomerates: stables of separate brands united under a holding company structure intended to spread best practice and impose commercial and financial discipline. The goal is to allow the firms to grow strongly without over-exploiting individual brands and killing exclusivity.

But the conglomerate model is not yet proven. By pursuing new customers, faster growth and higher profits, some of the new bosses have put a strain on their old brands. Despite their huge stable of luxury names, LVMH, Prada and Gucci are still heavily dependent on just one label. Investing in building a new brand is costly—and it offers no guarantee of success. Luxury has similarities to the drug industry in its blend of high margins and high, costly failure rates—even if it does not have to worry about patent expiry.

Speaking to *Le Monde*, Bernard Arnault, the boss of LVMH, recently noted another worrying trend. “Some brands reached their peak of notoriety at the end of the 1990s because they symbolised the show-off attitudes of the period. They have slid off the map of prestigious goods to become part of a sort of mass market for luxury items.”

Mr Arnault has tried hard to maintain the exclusivity of his labels, including Christian Dior, Kenzo and Fendi, even if it sometimes seems that every Japanese woman owns a Louis Vuitton handbag. But Ralph Lauren's Polo marque has ended up on everything from golf balls to tins of paint. And Philippa Ilincic, marketing manager at Gucci Luxury Timepieces, seems ambivalent about a “popcorn” bracelet that her group sells for £65 ($105) to attract new customers, adding with a little distaste: “It is hardly worth hallmarking at that price.” As Joan Rolls, a consultant, asks: “At what point do you stop in order to preserve your exclusivity? People already think Prada and Gucci are too mass market and not individual enough.”

Having already moved in the direction of brand over-exploitation, will the new breed of luxury bosses now err again by cutting costs too far in pursuit of short-term profits? Some trimming of expenses in response to the industry's ills is understandable. But not if that might mean a shirt from Yves Saint Laurent, part of Gucci, no longer has its label properly sewn in, as Christopher Everard of InterLife, a consultancy, found recently.

True, even the hard-hit quoted companies, with their shares under pressure, have continued to invest through the downturn. Richemont maintained its marketing spending during its past financial year, despite a 5% drop in sales, leading to a near-halving of operating profits. But few firms seem to have the gumption to make bold investments—except perhaps LVMH, which has hired an architect firm to design cathedral-like outlets for Louis Vuitton, reputedly at *euro*10m a piece, and may sell some watch assets to help foot the bill. Gucci is cutting its capital spending by half in 2003—in part, it is believed, to meet the pressing financial needs of its owner, the French retail giant PPR.

Prada, which remains family-owned and is run by Patrizio Bertelli, the husband of its designer Miucci Prada, has failed to complete the initial public offering of its shares it desperately needs to reduce its burden of debt, said to be *euro*1.5 billion. (Its profits last year were only *euro*27m.) There are rumours that it may follow the sale of its stakes in Church's, a shoemaker, and in Fendi by also selling its Jil Sander and Helmut Lang brands.

Yet Prada is being the boldest, splashing out $87m on a sci-fi-style store in Tokyo, said to be the biggest investment by an Italian company in Japan since the second world war. With its steel exoskeleton and latex-sheathed computer screens that coil down from the ceilings, the store could attract a whole new audience. “By using iconic architects, Prada is building brand equity,” says Mr Everard. By creating a buzz, he argues, the label will tempt younger, hipper shoppers who may remain customers for life. On the other hand, it could all be further evidence of the traditional excesses of family-run luxury firms that turned so many of them into basket-cases.

At Gucci, despite his recent battering, Mr De Sole expects to emerge in fine shape, and to continue along the strategic route that his firm had been navigating so successfully until recently. His bigger worry is whether he and Tom Ford, the firm's design overlord, can negotiate enough autonomy from PPR to justify their renewing their contracts. But he is optimistic about that too. Still, luxury's current woes have revealed unexpected stresses at several firms, and reminded everybody that hawking brands to the

mass-affluent is a risky strategy, with a high price for failure. Not the least of the dangers is that if the economy does not pick up soon, the affluent will be less massing than missing.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Sporting endorsements

Branded like Beckham

Jul 3rd 2003
From The Economist print edition

What David Beckham's transfer to Real Madrid reveals about the multibillion-dollar global business of sports sponsorship

PA

David who?

THEIR relationship became strained when David Beckham met his wife Victoria, a British pop singer known as Posh Spice, and developed this “fashion thing”, grumbled Sir Alex Ferguson, the curmudgeonly manager of Manchester United, when the soccer star he had reared since he was a teenager was sold to Real Madrid. This week, Mr Beckham joined the Spanish club amid the blaze of publicity that follows him everywhere. Which is the whole point for the third-most-valuable sporting personality in the world, after America's basketball legend, Michael Jordan, and its top golfer, Tiger Woods.

Sports sponsorship is a huge business—even Mr Beckham's contract-clinching medical was sponsored by a health-care firm. Roughly two-thirds of the almost $10 billion spent in sponsorship fees in North America last year was related to sports, estimate consultants with A.T. Kearney. The business is growing by some 9% a year. Globally, the market is probably twice as big, and growing faster. Add related advertising, marketing and so forth, and other costs, and the value of a deal often triples. What makes Mr Beckham such a hot property is that he is more than just a superb footballer.

Mr Jordan is now a brand in his own right, with such things as Michael Jordan's Steak House and Cologne by Michael, “developed to reflect Michael's transition from super athlete to stylish executive.” Mr Woods, who at 27 is just younger than Mr Beckham, is likely to become the first sporting billionaire—even before he reaches the middle-aged group to which his image mostly appeals (he promotes unflashy products such as Buick cars). For a fee, Mr Beckham is willing to pitch such delights as Castrol motor oil in Vietnam. But his main plus is that he can reach the part of the market that advertisers struggle hardest to influence: trend-setters.

Last year, Mr Woods replaced his Rolex (for a reported fee of $2m a year) with a TAG Heuer, owned by LVMH. But Mr Beckham can cause a sensation simply by getting a new hair style. Once, after he shaved his head, thousands of young men, from Manchester to Tokyo, trooped to their hairdressers to be scalped.

As far as brand managers are concerned, Mr Beckham's transfer might have been engineered in adland. He has a personal contract to promote Pepsi, an official sponsor of both Manchester United and Real Madrid. But although Nike sponsors United, Mr Beckham wears Adidas boots, under a personal deal with the German firm. Its boss, Herbert Hainer, says Mr Beckham's move is a “dream ticket” for Adidas because his firm also sponsors Real. United's main sponsor is Vodafone, which paid £30m ($46m) for a

four-year deal ending next year. The world's biggest mobile-phone operator, which is midway though a separate two-year personal contract with Mr Beckham, has no qualms about his move: it works with a Real sponsor, Siemens Mobile, a handset supplier.

When he was at United, Mr Beckham collected a wage for playing football (said to be £70,000 a week) plus a fee (around £20,000 a week) for the club to use his image as part of its own merchandising. At Real it is said he will be earning less. But his personal sponsorship deals could become far more lucrative, though he will have to hand 50% to the Spanish club.

Real is likely to recoup Mr Beckham's *euro*35m ($41m) transfer fee in just two or three years from the additional revenue that his joining is likely to generate, especially in Asia, where pictures of “golden balls” appear almost everywhere, and there are even gilded statues of him in Thai temples. More people watch Manchester United on TV in China than in England. Samantha McCollum of the London office of FutureBrand says that surveys of Asian fans show that around 30% follow the player rather than his team, which means that Real Madrid can expect an army of new supporters. Mr Beckham's debut with the club next month will be against Beijing's Dragon team, the first in a series of pre-season games in Asia.

Into touch

What do sponsors get for their money? Mainly a few days a year for photo-shoots, the filming of TV adverts and appearances at corporate events. But gone, mostly, are the pioneering days when a bored-looking celebrity endorsed a product on TV that nobody really believed he used. Today, both sponsor and player work hard to manage their respective brand risks.

Contracts can be arduous—insisting on, say, only a certain make of tennis racquet ever being held. Firms often impose tough “good behaviour” clauses, to minimise “O.J. risk”. The Hertz car-rental company quickly terminated its deal with O.J. Simpson when the American football star was accused of murdering his wife. For the most part, stars such as Mr Beckham work hard at their image—not least because they hope to follow Mr Jordan and maintain a brand value after their sporting days are over. Mr Jordan has parlayed himself into a model businessman.

Mr Beckham has been “good value,” says Mike Caldwell, Vodafone's director of communications. He has re-branded as Vodafone the firm's Japanese subsidiary J-Phone, and in Britain he helped to launch Vodafone live!, a new service with features such as picture-messaging. Although Finland's Nokia dominates handset sales in Europe, its phones have been outsold in the new service by a relatively unknown handset made by Japan's Sharp, which became known as “the Beckham phone.”

Yet Vodafone does not always use Mr Beckham. In Germany and Italy, its star is Michael Schumacher, the Formula One motor racing champion. Nor does Mr Beckham appear in Vodafone ads in his football kit. In part this is not to offend fans of rival clubs, but mostly because the firm is using him as a “lifestyle icon”.

That may be Mr Beckham's most powerful role—and the way to extend his brand, à la Jordan, after he hangs up his soccer boots. Trend-spotters mark him out as a “metrosexual”: a heterosexual urban man who enjoys fashion and grooming products, and even activities such as parenting, that are traditionally associated more with women (see article). This may raise untrimmed eyebrows in Madrid. After he appeared in a series of pictures with his scantily clad wife, wearing painted nails and a studded wrist-band (Becks that is, not Posh), *El Mundo*, a Spanish newspaper, wondered how this strand of British “queerness” would play with Madrid's famously macho fans.

It will be interesting, to say the least. So, too, will be his efforts to make it in America, where Mr Beckham is even less well-known than his briefly famous wife. During a recent attempt to promote themselves there, Mrs Beckham told the *New York Times*: “We want to have our own brand. There are so many things that interest us—fashion, make-up...”

Alas for Mr Beckham, his Spanish move means he will not now accompany Manchester United on a series of exhibition matches in America. Although no European soccer club could become as famous in America as the New York Yankees or Los Angeles Lakers, the tour would have raised Mr Beckham's profile. Mr Jordan and Mr Woods seem safe, for now, atop the sports-sponsorship league.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Metrosexuality

Real men get waxed

Jul 3rd 2003
From The Economist print edition

A new male market emerges

JAMES BOND always gets the girl. His suave image is attractive to advertisers, which is why Ford renewed the spy's association with Aston Martin with a product placement for him to drive one of its British-built sports cars in “Die Another Day”. But Bond is no Beckham.

When David Beckham ties back his hair or wraps himself in a sarong, or his wife says he wears her thongs, he sends a powerful message to a new kind of male, according to Marian Salzman of Euro RSCG Worldwide, a leading advertising agency. This new target market is “metrosexual”, a term coined a few years ago to identify straight urban men who enjoy such things as shopping and using beauty products. It is sometimes described in lad mags as being “just gay enough” to get the babes.

Mr Beckham, says Ms Salzman, is a classic metrosexual. So too is Bill Clinton, she insists—especially as he has apologised and now carries Hillary's autobiographies for her to sign.

Ms Salzman has tested the market and concludes that 30-35% of young men in America have metrosexual tendencies: tell-tale signs include buying skin-care cream and fragrances. Also popular is having non-leg body hair removed, via a so-called “back, crack and sack” waxing. Celebrities such as Mr Beckham make it all right for straight men to do such odd things.

If Ms Salzman is right, then much advertising for men's grooming products could be way off mark, as it uses images of a hot, sweaty hulk rolling deodorant under his hairy armpits. This matters: the grooming market for young males in North America was worth around $8 billion last year, and is growing fast.

Some big firms are cottoning on to this, which suggests that metrosexuality—or something like it—may actually exist. Last year, when Unilever launched Axe in America (Lynx in some markets) as a fragrant all-over body spray, it said: “Personal care and grooming, traditionally the provinces of women, are increasing in importance to young men, and this trend is expected to increase”.

Following the earlier emergence of “New Man”, there will presumably come a cross-over point in gender differences. A new generation of sweaty Amazons will go out on the town while the guys stay home to do their hair.

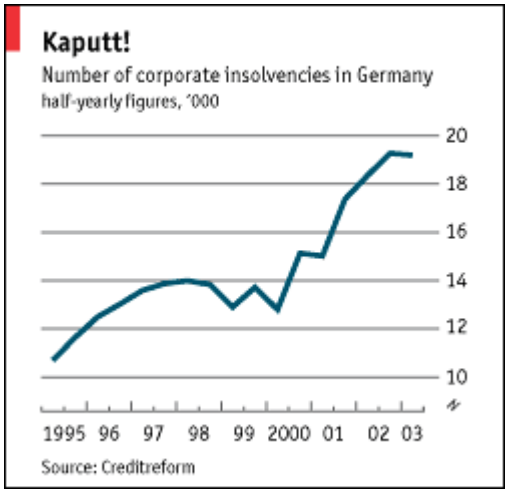
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

German restructuring

Second chances?

Jul 3rd 2003 | OBERHAUSEN
From The Economist print edition

Babcock Borsig's bankruptcy has delivered encouraging results



THE gloom in German business lifted a bit this week when IG Metall, Germany's mightiest trade union, lost a strike for the first time since 1954. Other good news, however, has been less heralded. Struggling German companies have been taking advantage of the country's revised bankruptcy procedures to buy themselves a reprieve from corporate death sentences.

When Germany overhauled its bankruptcy rules in 1999, some hailed the arrival of a "German Chapter 11"—referring to the American insolvency code that gives firms unable to meet their obligations to creditors a stay of execution while they try to sort out the mess. Now this claim is being put to the test.

In the first half of 2003, nearly 20,000 businesses filed for insolvency (see chart), and a record 40,000 may do so by year-end. High-profile bankruptcies have dominated the headlines. Grundig, a radio maker, went under in April, after a bid from a Turkish investor collapsed. Fairchild Dornier, an aircraft maker, called it quits last year during a dismal period for the airline industry. Both have been all but liquidated—the usual fate of bankrupt German firms before the law changed.

A year ago, Babcock Borsig, a metal-bashing conglomerate and mainstay of the Ruhr region, went bust. With 21,000 employees, this was a huge embarrassment for the government—which ultimately declined to provide a "Berlin bail-out", the old way of rescuing big firms deemed too important to be liquidated. Instead, Babcock was left to sort out its problems on its own under the new law. Along with KirchMedia, whose break-up is crawling along, Babcock is one of the first big experiments in a more orderly approach to business failure.

Like America's bankruptcy code, the new law aims to give companies a chance to trade on, sort their problems out, preserve jobs and even help capitalists get some money back. It is not as creditor-friendly as the old German law, which quickly wound firms up to repay (some of) their debts as fast as possible. But nor is it as debtor-friendly as the American law. Managers of troubled German firms have only a matter of days after they realise their firm is failing in which to declare themselves insolvent. Otherwise, they risk jail. (A great way to "focus the mind," quips one insolvency expert.)

Almost as painful, once bosses put their firm into insolvency they must usually hand over the reins of power to a court-appointed bankruptcy expert—whereas in America managers who bust the firm often stay on. In Babcock's case, the court-appointed boss was Horst Piepenburg, a Dusseldorf lawyer and insolvency expert. Arriving last July, he found Babcock in terrible shape. An unwieldy conglomerate of over 300 businesses, it had been broken by overseas competition and (typically German) high labour costs.

Mr Piepenburg trimmed the firm, selling Babcock's American assets to one American private-equity firm and its remaining share in HDW, a submarine maker, to another. Other parts were hived off to Hitachi of Japan, where unwieldy conglomerates are still in vogue, or closed down. This seems to have delivered the goods. Nine in ten of the original employees still have jobs, says the company, no doubt making the government happy. Creditors will recover around 10% of their loans, which is better than nothing.

This ought to encourage more attempts at Babcock-style "self-administration". "Debtor in possession"

financing, the special protected lending to bankrupt firms in America, is still rare, and it would help. So would a greater willingness among bankers and bosses to treat insolvency as a routine part of business, and to use it more readily. That might encourage an even more fundamental change in Germany: the revival of entrepreneurial spirit. That will not happen so long as bankruptcy is still equated with disgrace, worthy in some cases of suicide.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Russian oligarchs

The boy done good

Jul 3rd 2003 | MOSCOW
From The Economist print edition

In Russia's business elite's pursuit of respectability, a new strategy

THE sun will no longer set on Roman Abramovich's empire. After buying control of Chelsea Football Club this week for £60m ($100m), plus its debts, the 36-year-old multi-billionaire has assets stretching from London via 12 time-zones to the north-eastern Russian province of Chukotka, where he is governor.

The purchase may not win him many admirers in Britain, which has seen its share of rich foreigners with interesting reputations buying football clubs in an attempt to look respectable—most notably Mohamed Al-Fayed, the owner of Fulham FC, who also had his sights on Chelsea at one point. But if Mr Abramovich is trying to impress anyone, it is probably not the Brits. Buying a top English team, in a part of London where lots of rich Russians have second homes, will get him plenty of kudos in Russia—especially if his money can turn the club into a championship winner.

For Mr Abramovich, it is a low price to pay for respect. He has long been one of the most reclusive and mysterious of Russia's oligarchs. An orphan, he got into business in the dying days of the Soviet Union, but made his money after buying Sibneft, a medium-sized Russian oil firm. Like Yukos, a bigger oil firm, Sibneft went from being an inefficient monster, acquired who knows how, into an investors' darling. But where Mikhail Khodorkovsky, boss of Yukos, remodelled himself as the poster-boy of modern Russian business, Mr Abramovich has not shaken off his old image.

In part that is because he is more of a profiteer. He sold most of his Sibneft stake to Yukos in a merger earlier this year—the deal included $3 billion in cash, out of which Chelsea's price was but pocket change—and also holds or has held large stakes in some of the country's biggest aluminium, car, airline and media firms. His bid for the Chukotka governorship (which he won after showering largesse from his own pocket on the dirt-poor population) was puzzling, but turned out to make business sense: the law then allowed the governor to grant tax waivers to trading firms that Sibneft had registered in Chukotka. For three years, Sibneft's effective tax rate was the lowest of all the Russian oil majors, says Troika Dialog, a Moscow investment bank.

Yet Mr Abramovich does not seem to have the itch to influence politics that has hurt some of his peers. He and Boris Berezovsky, who helped him buy Sibneft, were among the businessmen in the inner circle of President Boris Yeltsin, and had probably expected to have some sway over Vladimir Putin, Mr Yeltsin's hand-picked successor. But Mr Putin turned out to be tougher, and Mr Berezovsky, who had used his television channels to attack the new president, wound up in exile in London, a political outcast and a national laughing-stock.

Mr Abramovich, by contrast, had the sense to keep out of the way. More recently, Oleg Deripaska, an aluminium magnate, incurred the Kremlin's displeasure over his involvement with a regional election, and there are signs that Mr Khodorkovsky, too, is rattling nerves with his increasingly clear political ambitions. Mr Abramovich, however, seems to want only to make loads of money and have a laugh spending it—just like any Chelsea supporter.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

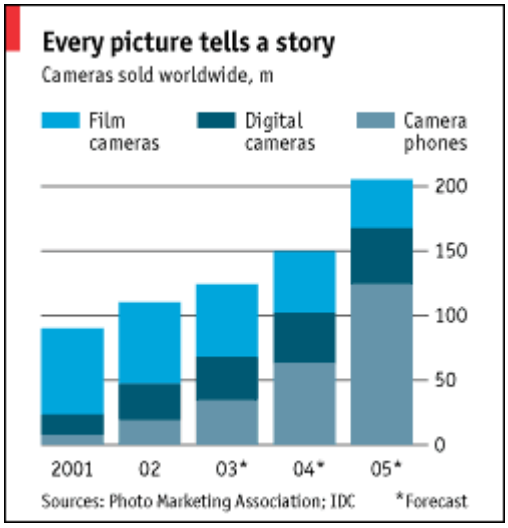
About sponsorship

Digital photography

Mobile snaps

Jul 3rd 2003 | SAN FRANCISCO
From The Economist print edition

Are camera-phones good news or bad for the photography industry?



FACED with the rise of digital cameras, the conventional photography industry is doing its best to smile. Sales of digital cameras will pass sales of film cameras in America this year. Globally, the crossover will happen in 2005. This is bad news for makers of film and paper, such as Kodak and Fuji, because people with digital cameras take more pictures, but make fewer prints. They tend to share pictures over the internet, making only a few prints at home from their PCs using ink-jet printers.

Hence the industry's efforts to persuade digital-camera owners to order prints from high-street minilabs, in-store kiosks, or over the internet. But now a new threat has appeared: camera-equipped mobile phones. These could change the nature of photography entirely, because they make sharing digital snaps far easier—and they will soon outstrip both film and digital cameras (see chart).

Sales of camera-phones are expected to grow from around 19m in 2002 to over 34m this year, according to IDC, a market-research firm. By 2005 they are likely to outsell film and digital cameras put together. Photo-messaging, the ability to zap pictures from one handset to another, is taking off and is already hugely successful in Japan. When the new Sony Ericsson SO505I camera-phone was launched in Japan recently, 40,000 units were sold on the first day. Its 1.3-megapixel sensor produces images sharp enough for a standard four-by-six-inch print, making it a serious alternative to conventional cameras.

No one is sure how this will change consumer behaviour. It could take digital photography beyond PC users and into the mainstream. When you have a camera with you at all times, notes Michelle Slaughter, an analyst at InfoTrends, you are likely to take more pictures, which you might want to print. So if printing can be made easy enough—perhaps by beaming snaps to a kiosk, or ordering prints via the handset—it might expand the market for prints. As a result, firms such as Kodak, Fuji, Hewlett-Packard and Canon are all working to extend their digital-printing technology for use with camera-phones.

But camera-phones might also hasten the decline of printed photos. As handsets improve, viewing images on-screen could become the norm, whether on phones, PCs, televisions, or even by beaming photos to a wireless-enabled picture frame next to Grandma's chair. In the worst case, “printing could become a niche, like film is expected to,” says Chris Chute of IDC. This is the nightmare scenario for the photography industry, which currently makes money on each snap (on film) and print (on paper). Digital photography is already doing away with the first source of revenue. Mobile operators charging for transmitting images might grab the second.

It is also possible that camera-phones will become ubiquitous, but that most people will use the camera feature only rarely, when no other camera is available. Phones are, after all, already the most numerous messaging devices on earth, and will soon become the most numerous gaming devices—but people still use PCs and video-game consoles.

About the only thing that can be said for certain is that they are sure to be put to unexpected uses. Already, camera-phones have been banned in some factories to prevent industrial espionage. Flourishing websites in a number of categories (many of them dubious) display pictures sent in by phone-toting users. There are even tales of camera-phone owners being asked to send photo-messages verifying their whereabouts to suspicious spouses.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Big Food v Big Americans

Thin end of the wedge

Jul 3rd 2003 | NEW YORK
From The Economist print edition

Mea culpa

AT LAST, in the face of mounting public outrage and the civic-minded efforts of America's trial lawyers, Big Food is coming out of denial. As was plain all along, the “supersizing” of Americans owes nothing to lifestyle choices that mix zero exercise, cola and burgers in huge quantities, along with a near-criminal lack of parental responsibility for the health of their children. No: the reason why “little” Jimmy weighs 200 pounds, has an enlarged heart and suffers from diabetes is because McDonald's, Kraft and Coca-Cola made him that way. And Kraft, for one, has now decided to come clean.

On July 1st, it announced a new “obesity initiative”, to be fronted by a global council, dispensing advice on food-marketing practices, labelling and portion sizes—which will shrink. No longer will American children and their duped parents be led, wickedly, to supermarket shelves groaning with Kraft's Kool-Aid Slushies and buckets of Tempt-tee cream cheese. From 2004, all Kraft products will be clearly marked as health hazards.

Also with tails now between their legs are PepsiCo, maker of new, slightly less unhealthy, Cheetos snacks, and McDonald's, which is testing the national appetite for fruit instead of French fries with its “Happy Meals”. This moniker, by the way, is clear evidence of Big Food's ruinously deceptive marketing, as eating lots of them creates fat, unhappy people.

Notwithstanding the recent scandalous failure of a fat lawsuit against McDonald's, the trial lawyers, and their expert witnesses in academia and the medical profession, vow not to rest until the conspiracy is laid bare. But Kraft, perhaps not fully out of denial, refuses to pay up. On the contrary, says the firm, it wants to “make sure the products we sell and how we sell them are responsive to changing patterns of diet, activity and weight”.

If Kraft has an appetite for such changes, it is not clear that most Americans do. Despite the hopeful pictures of fruit-eating, bicycle-riding Americans given prominent display at Kraft's website, the country's backsides continue to expand alarmingly. The obesity “epidemic” now claims one in six children and one in three adults. Still, Kraft's efforts to persuade Americans to spend more money on smaller, cheaper-to-make “healthy” portions might, if it works, really provide evidence of evil marketing genius.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Face value

Trying to be a regular Ghai

Jul 3rd 2003
From The Economist print edition

Subhash Ghai wants to turn Bollywood into a respectable business

TINSELTOWN is, as always, in a scandal-induced tizzy, even when it is in India. Shilpa Shetty, a glamorous film star, has been questioned by the police about allegations of extortion levelled against her parents. They say she is owed money by a firm called Prafull Sarees for some advertising work. Prafull's boss says that Mr Shetty, Shilpa's father, threatened him, and that he was in cahoots with a notorious gangster.

In Bollywood, an industry in deep trouble, there may be no such thing as bad publicity. But this story does hint at two reasons for its plight: it depends more on the pulling powers of pretty stars of often unappealing habits than on the quality of the product; and its links with the murky world of the mob are the stuff of legend.

Cut to another part of town. In an office decorated with framed commendations from, among others, a respected economic daily and an American senator, Subhash Ghai is trying to run his patch of Bollywood as a normal business. Mr Ghai's other credentials include 15 films as a director (12 of which were, in his self-effacing description, “blockbusters”). His firm, Mukta Arts, this year released its first in-house production as a stockmarket-listed company, a comedy called *“Ek aur ek gyarah”* (“One and one make eleven”).

Since it broke new ground with a public offering of its shares in 2000, Mukta has financed one other outside production, but it has concentrated more on building up its in-house “story bank”. It has also been working on “forward and backward integration”. That means, looking forwards, the building of its own distribution network; and, backwards, setting up an international film institute, to open in Mumbai in 2004, that expects to train 200 professionals each year.

Mr Ghai dreams of Hollywood. “Our endeavour”, he boasts on Mukta's website, “is to recreate the magic of the powerful studio system of the early 1930s and 1940s, a system that created the Big Five studios. Studios that etched cinema history.” Mukta's listing was part of a broader trend towards “corporatising” Bollywood, the Mumbai-based Hindi-language film industry. Bollywood produces about 200 films a year, roughly a quarter of India's entire cinematic output, most of which is in regional languages such as Tamil and Telugu.

The cinema's popularity in India has long attracted serious business interest. But its chaotic management and finances have deterred serious commitment. Most films have been privately financed, often at monthly rates of interest of 2% or more. Many of the lenders were, well, not nice. Cost overruns and production delays have been endemic. Stars promised themselves to two or three simultaneous productions. Three-quarters or more of films have lost money—even worse than in Hollywood.

In 2000, the government gave film-making official “industry” status, opening it up to more conventional sources of bank finance, including loans from the government's own Industrial Development Bank of India. Meanwhile, a stockmarket boom, in which media-company shares soared, encouraged others to follow Mukta into the market.

They arrived just in time for the bust. Although such Indian films as “Lagaan” and “Monsoon Wedding” won international plaudits, last year was the worst that anybody can remember. Kamal Nahata, editor of *Film Information*, a trade journal, reckons that 95% of films lost money. According to Mr Ghai, revenues in the industry have fallen by 40% over the past three years, even though people are watching more than twice as many films. Piracy has mushroomed with the spread of DVDs and VCDs, and as cable television has penetrated more than 40m homes. Many cable operators—small, corner-shop operations—air their own channels of non-stop pirated movies.

Mr Ghai is optimistic that by distributing films in digital form as well as on 35mm prints he can beat the pirates. He hopes to launch new releases at 1,000 of India's 12,000 cinemas at once (as opposed to only about 300 currently). Many cinemas, meanwhile, are being refurbished into more attractive multiplexes. Mr Ghai, who chairs a new film-industry committee at the Confederation of Indian Industry, is lobbying for cinema tickets to be made cheaper. Entertainment taxes, levied on ticket prices by state governments, range from 50% to 100%. Mr Ghai wants a preferential national rate of 20% for films in Hindi (which is the national language, after all).

Cable killed the video star

Others, however, think that cinema revenues are in secular decline. “Bollywood has the glamour,” says Farokh Balsara, who runs a media consultancy at Ernst & Young in Mumbai, “but television is where the money is.” Even Mr Ghai says that success depends on diversifying sources of revenue. The Mukta-financed “Yadein”, for example, covered its costs on sales of the music. And a five-year deal in 2002 with Sony Entertainment Television for the rights to air 11 films from Mukta's back catalogue yielded some 160m rupees ($3.3m).

Film Information's Mr Nahata thinks the cinema has been doing badly for the simple reason that “the content is substandard” (a category into which his magazine also puts *“Ek aur ek gyarah”*). He argues that, a few exceptions like Mukta Arts aside, Bollywood is not ready for corporatisation. That “presupposes self-discipline”, but “whims and fancies rule the industry.”

Dev Anand, a former matinée idol who is now one of India's best-loved film-makers, confirms this view with his description of his fund-raising strategies: “I'm not a waster; I don't overshoot. I am a good person. People give me money.” Very endearing, perhaps, but it hardly dispels the impression that, as a business, Indian cinema, rather like “One and one make eleven”, still does not really add up.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Private equity

The charms of the discreet deal

Jul 3rd 2003
From The Economist print edition

Secretive private-equity firms are behind many of today's biggest corporate deals. What exactly are they up to?

DISENCHANTED with public stockmarkets, wealthy investors have for some time been seeking alternatives. Low returns on quoted shares, and countless scandals over rigged results and the excessive pay of top managers, have encouraged them to look elsewhere. One popular alternative has been private-equity funds, multi-billion-dollar pools of money that are involved in many of today's biggest and shrewdest corporate-finance deals.

The firms that manage these funds are increasingly well known. The doyen is probably the Carlyle Group, which employs a former American president (George Bush) and a former British prime minister (John Major). Its reputation for behind-the-scenes power-broking was enshrined in a recent book ("The Iron Triangle: Inside the Secret World of the Carlyle Group" by Dan Briody). Other leading firms include the Blackstone Group, which has raised over $14 billion of private equity, and Kohlberg Kravis Roberts (KKR), forever famous for its $25 billion leveraged buy-out of RJR Nabisco in 1988, immortalised in the book "Barbarians at the Gate".

Such firms are not short of business these days. When the owner of America's NASDAQ wanted to rid itself of the American Stock Exchange earlier this year, it turned to a Chicago private-equity firm for help. The Blackstone Group and Thomas H. Lee, another top-ranking firm, are currently trying to help Edgar Bronfman to regain control of Universal Studios, Vivendi's dabble with Hollywood, now that the French conglomerate wants to shed the farther-flung assets that it acquired during the stockmarket boom.

Europe too is seeing plenty of action. On June 11th, investors led by a pan-European private-equity firm, BC Partners, bought Seat Pagine Gialle, a telephone-directories business, from Telecom Italia for *euro*3.04 billion ($3.55 billion). This was the biggest private-equity deal ever seen in Europe, and it was won by BC Partners against stiff competition from American firms such as Carlyle and KKR.

The enthusiasm for private over public markets, however, is giving investors no guarantee of superior returns. For one thing, it is extremely difficult to calculate the returns on private-equity funds (more of that later); and for another, those returns depend crucially (and with not a little irony) on the public markets. Most private-equity deals look ultimately to a stockmarket for their returns. Take the example of Yell Group, a telephone-directories business bought from British Telecom in 2001 for some $3.5 billion by a group of private-equity investors. Those investors are currently trying to realise some of their gain (if there is any) through an initial public offering (IPO), a sale of shares on a public stockmarket. The roadshow to advertise the offering began this week.

First find the exit

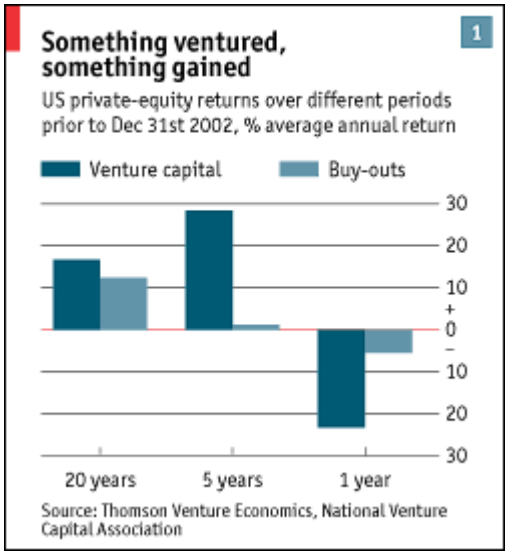
Private equity has a broad definition—any equity not traded through a public exchange can be included, whether it be a family firm, a young biotechnology start-up, or even Bill Gates's holding in Microsoft. All types of private-equity investment, however, share some basic features:

•The investors are typically wealthy and supposedly sophisticated—they include family trusts, university endowments and big pension funds, especially state-run ones.

•Private-equity firms take substantial stakes in a portfolio of companies, giving them the power to sack managers and appoint new ones, with the intention of building better, more valuable businesses.

•Their route to profit is via an “exit”—a way of selling the firm, or bits of it, at a higher price than was paid for it, on some long but fixed time-scale of between three and ten years. Such a sale often takes place through a public stockmarket.

At one end of the business are the venture capitalists (VCs) who try to get in on the ground floor, building companies from nought. Thomson Venture Economics, a research company, reckons that the returns on venture capital have been better than on other forms of private equity (see chart). But the venture capitalists' heavy involvement in the short-lived telecoms, media and technology boom has turned sour and they are slowly facing up to the painful realities of their tattered portfolios.



Being private partnerships, however, they are under little pressure to be open about the true worth of those portfolios. A common ruse is to carry the value of companies at cost, even when it is clear (as it often is) that a buyer would have to be paid to take the companies off the VC's hands. Lay-offs at prestigious VCs such as Boston's Battery Ventures suggest that all is not well in the industry.

Scott Delman of Capital Z, a private-equity investor, thinks the venture-capital industry still has a long way to fall. Apart from the absence of a big new thing in technology—even investment in biotechnology fell in 2002—he sees long-term structural problems for the industry. As with other forms of private equity, VCs usually find their exit (and hence their reward) by floating off investments through an IPO. But technology-focused investment banks—such as Montgomery, Hambrecht & Quist and Robertson Stephens—which used to serve as the pipelines to an IPO, have either gone bust or been swallowed up by bigger rivals.

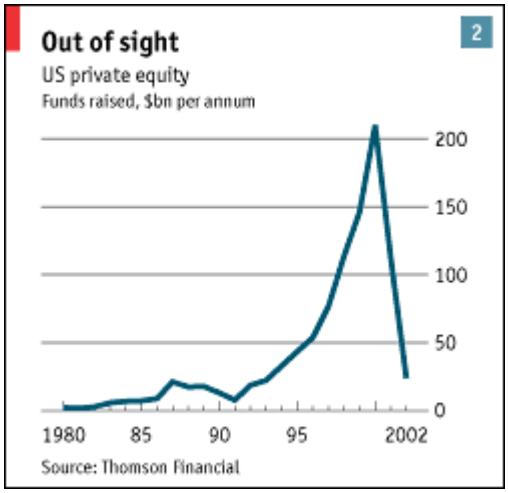
An article by William Meehan, a McKinsey consultant, in this month's issue of the *Harvard Business Review*, predicts a shakeout in the VC industry, “one that in the worst case could force up to half of all current VC firms to close shop over the next several years.” Mr Delman is more precise about the timing: “I see around 50% fewer venture-capital funds in the next two to three years,” he says.

Venturing elsewhere

As the venture capitalists rest, the buy-out side of the private-equity business—the funds that purchase whole companies, or big chunks of them, often borrowing heavily for the purpose—is growing strongly. Huge amounts of money have flowed into private-equity funds in recent years (see chart), though the flow dropped off sharply last year. Much of it has been waiting to find an investment home. For many, buy-outs are proving to be that home.

The opportunities are widespread. The Carlyle Group, for example, is seeking to take advantage of changing political attitudes to aerospace and defence. Along with Finmeccanica, a state-owned

Italian defence company, it agreed this week to buy a bunch of aerospace businesses from Fiat Avio, a division of the Agnelli family's troubled conglomerate.



Many funds see Germany—where such big companies as Siemens are struggling to restructure, and medium-sized *Mittelstand* companies are looking for ways to grow beyond their founding families—as especially fertile ground. Likewise the telecoms industry, where debts taken on in the boom years are now crippling many companies. Typically, the publicly quoted Telecom Italia nudged Seat Pagine Gialle to become private in order to reduce the high debts that it had taken on in the years when nobody said “No”.

Overall, deals such as these are more typical than headline-hitting blockbuster takeovers like the legendary RJR Nabisco deal, although KKR did take a trip down memory lane earlier this year when it (unsuccessfully) tried to take over Britain's Safeway supermarket chain, a company that it had taken private in the mid-1980s before returning it to the public markets (and making a large profit).

Some VCs have switched their business to benefit from this shift to buy-outs. 3i, for instance, is a London-based private-equity fund that once styled itself as a venture capitalist and poured millions into technology start-ups. Yet one of its most successful recent deals has been a traditional buy-out. In 2001, it took a stake in British Airways' low-cost subsidiary, Go, in return for £110m ($175m) of financial backing for a management buy-out. Barely a year later, it sold the stake to easyJet, an independent low-cost airline, for £374m. Not a bad return for a year's work, though it barely compensates for all 3i's technology investments that have gone sour.

Another firm that has adjusted to changing market conditions is Hicks, Muse, Tate & Furst, one of the firms behind the Yell deal. After a disastrous foray into telecoms, it is now most proud of a much less sophisticated deal: a buy-out of the maker of “Hungry Man” frozen dinners. Hicks, Muse is so involved with the company that it even supervised one of its advertising campaigns.

A buyer not a seller be

Many of today's buy-out opportunities have arisen out of the hangover from the investment boom of the late 1990s and the world economic downturn. Firms in a host of distressed industries are looking to dispose of non-core businesses, and the buy-out funds are eager to help them. A private-equity firm called Texas Pacific, for example, snapped up the assets of Swissair's catering operations after the carrier went bust. And, on top of its aerospace deal with Carlyle, Fiat also recently unloaded some of its other assets to a French private-equity-style fund called Eurazeo.

A number of private-equity groups have taken advantage of the agony of the telecoms industry to buy companies' cash-rich yellow-pages subsidiaries. In Britain there was the Yell deal, and last year saw the biggest leveraged buy-out since that of RJR Nabisco: the $7 billion purchase in August by two firms of QwestDex, the yellow-pages subsidiary of Qwest, an American telecoms firm in difficulties.

America's bankruptcies, from WorldCom to Enron, and a host of distressed companies, such as Tyco and Adelphia, have provided further opportunities. Adelphia, a cable-television company, went so far as to approach a small private-equity firm to offload its stake in a New York hockey team.

America's bankruptcies and distressed companies have provided plenty of opportunities

Vivendi Universal, whose ill-fated expansion under Jean-Marie Messier was largely unwound last year, gave birth to one of the biggest private-equity deals of 2002: Houghton Mifflin, an old Boston publishing house, was sold to a group of private-equity funds for 25% less than Vivendi paid for it a year ago. Both American and European private-equity firms are salivating at the prospect of disposals to come from the likes of ABB, Deutsche Telekom, France Telecom and Siemens.

The pressure for returns

Deals would be even bigger were it not for constraints on the ability of private-equity funds to borrow in order to leverage their buy-outs. Back in the 1980s, a buy-out firm would put up only 5% of the value of a deal in equity; the other 95% would be financed by debt, in the form of bank loans and/or junk bonds. By the late 1990s, however, the required equity stake had widened to 20% of a deal's value. Now, with big banks' balance sheets stretched, the buy-out specialists are finding that they have to put up around 30-40% in cash.

Raising that much is not necessarily an obstacle, especially when firms work together (as they increasingly do). But lower leverage threatens to yield sharply lower returns in future. As it is, returns on private equity are notoriously hard to measure because investors' cash is put into many different companies at many different points in time. Since most companies in a portfolio have no stockmarket listing, there is no reliable guide to their value.

Comparing a private firm with the share price of a similar listed company is one way to get a figure, but it fails to account for the extra value of holding a controlling stake. The only true measure of returns is the cash that is received when the portfolio firms are sold, either to other companies or through an IPO. In the meantime, investors have to rely on the “internal rate of return” (IRR), a mathematical calculation of returns that gives many a rocket scientist a headache.

Moreover, there is no single accepted formula for calculating the IRR. And the figures that go into the calculation are often fudged, relying as they do on a fund manager's whimsical judgment of what a company could be sold for. Rarely does this estimate fall below the cost of the investment, at least until the day of reckoning comes. In the private-equity world, such sunny optimism in valuation is referred to as “sticky” pricing.

Dodgy valuations also arise when private-equity firms sell or swap assets among themselves, an activity that is growing in popularity. This provides them with a way to rejuggle their portfolios, but it does have a downside: the prices that they record for these deals may have nothing to do with the prices that the assets would fetch on an open market.

The public side of private

The desire of investors to shuffle their assets has fed a burgeoning, though still highly secretive, secondary market in private equity. This allows them to cash out of their holdings long before a fund reaches the end of its life. Jeremy Coller of Coller Capital recently raised a $2.5 billion fund to invest in this secondary market—larger than most primary-market funds. The move is likely to create more trading, and eventually more price transparency, for shares in private-equity funds.

Transparency has recently received a boost. Two big pension funds in California and Texas have thrown more light on the shadowy world of private equity than has been seen since the industry's inception. Prodded by lawsuits, CalPERS and UTIMCO, a University of Texas endowment fund, have published their performance figures—including the IRRs of their private-equity portfolios. Most worrying is how little help most of the IRR figures are, since most private-equity investments have as yet returned precious little cash.

There is another concern for private-equity investors apart from the lack of transparency. The stealthy and scrappy investors who used to run the business are being joined by the establishment. Some of the world's best-known bosses are finding second careers in private equity: GE's former boss, Jack Welch, is at Clayton, Dubilier and Rice; Jacques Nasser, who once ran Ford, is with One Equity Partners; recently, Lou Gerstner, IBM's former chief, joined the Carlyle Group. Mr Gerstner's arrival has led to speculation that the firm is looking to be the first private-equity firm to make its own exit and go public.

Some of the world's best-known bosses are finding second careers in private equity

Others have already tried to take steps in this direction. KKR tried last autumn to sell part of itself to the Washington and Oregon state pension funds. Another big firm, Thomas H. Lee, has formed an alliance with Putnam Investments, a high-street vendor of mutual funds. The holy grail of private equity is to allow individual investors to put their money into private businesses. Surely, critics say, the end is nigh when private-equity firms themselves are no longer private.

It's the management stupid

The firms' high-profile recruits are a belated recognition that they need to improve their management skills. They all now make noises about being more than just buyers and sellers of companies, or of chunks of them. Financial engineering, which used to be the buy-out firms' primary focus, is now out of fashion. Firms today claim to be helping the managers of their portfolio of companies with everything from strategic advice to headhunting to, in one case, sending in their high-cost MBAs to ring up customers and collect unpaid bills. With the spate of recent deals, however, some are sceptical that the firms are up to the task of turning round so many struggling businesses at once.

Nevertheless, there is a premium today on more traditional skills, such as choosing a management team and building relationships with customers and suppliers. For example, when Texas Pacific bought Burger King from Diageo, a food-and-drinks conglomerate, one of its first moves was to add an expert in restaurant turnarounds to the management. Obvious stuff, perhaps, but this is the way in which private-equity firms expect to be able to add value in future.

The importance of these more pedestrian skills may explain the rise of niche funds that aim to tackle buy-outs in only one industry, be it health care, fitness centres or publishing. With cash piles in the hundreds of millions rather than the billions, these are better placed to devote time, effort and industry expertise to turnarounds. One such fund, Falconhead Capital, specialises in consolidating suburban health-and-beauty shops in America's roadside shopping centres.

Improving management and operations is something that the American funds talk about more loudly than the Europeans. Firms in Europe are seen primarily as catering to management buy-outs (MBOs), in which a fund acts as a source of money for existing managers to take over their own operations. The fund then remains in the background on most of the big operational decisions.

Improving management and operations is something that the American funds talk about more loudly than the Europeans

The Americans had hoped to make a big splash in Europe with their different approach. Many big funds, such as KKR and Clayton Dubilier and Rice, made much of taking on Europe at the turn of the century, counting on corporate restructuring and a hoped-for boom in M&A in Germany. But it has not worked out quite as planned. Clayton had to write off $400m when Fairchild Dornier, a German aeroplane-maker which it bought in 1999, went bust last year. And KKR's adventures in Russia left its fingers badly burnt.

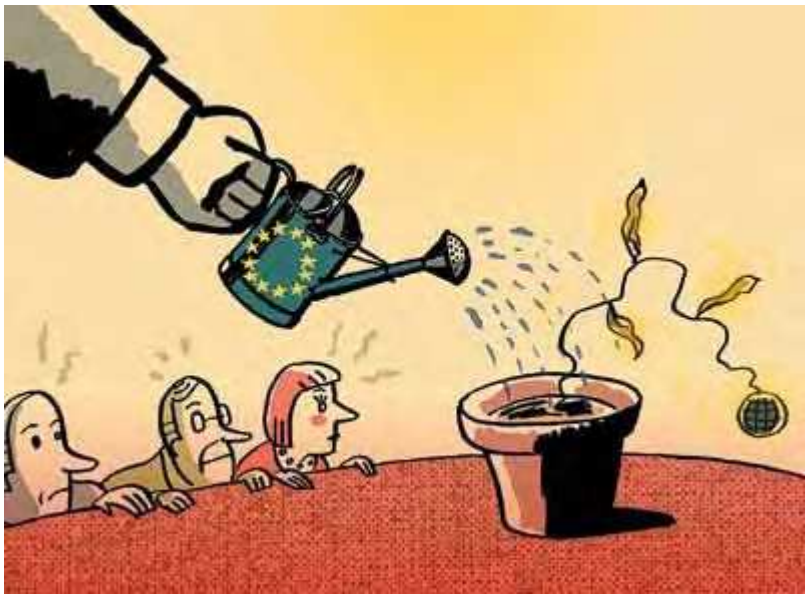
Nevertheless, private equity's best hope is to become what it has long claimed to be: an improver of companies. As one industry insider puts it: the 1980s were about financial expertise, and the 1990s were about specialisation and deal-making. But the next phase must be about improving operations. That means the industry's smart MBA types will have to roll up their sleeves and get much more involved in management.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

World trade

Drops on parched soil

Jul 3rd 2003 | BRUSSELS AND WASHINGTON, DC
From The Economist print edition



Can Europe's agriculture deal revive the world trade talks?

FOR months, the European Union has been the whipping boy of the Doha round of trade talks. The EU's inability to reform the Common Agricultural Policy (CAP), its gargantuan farm-subsidy system, was seen by almost everybody as the main reason why a ministerial summit to be held in Cancun, Mexico, in September might fail. No longer, or so claim European officials and ministers. The EU trumpeted a package of reforms announced on June 26th as “a new era for European agriculture”, with a farm policy that is “trade friendly” and where Europe has a “strong hand in the negotiations.”

This is almost certainly hubris. Luis Portugal, an agricultural economist at the OECD, says: “It's not a revolution, or even a very big reform.” He points out that the EU has not yet touched sugar, cotton or tobacco, commodities where the EU's protection is especially harmful to poor countries. Mr Portugal and others are yet to work out its effects on trade. Its impact on the Doha talks is equally uncertain. As one ambassador to the World Trade Organisation in Geneva says, EU-speak must be translated into WTO-speak. That means sorting out how much extra room the EU's negotiators now have in the three main areas of farm-trade talks: reducing trade-distorting subsidies, cutting export subsidies and improving market access.

Originally, agreement in all three areas was due by March 31st. America made a bold proposal last year: much lower tariffs and trade-distorting subsidies, so that those with the biggest subsidies and highest tariffs would have to cut most; and the elimination of export subsidies. Europe, however, came up with a more timid offer and flatly rejected the principle of harmonisation. A compromise proposed by Stuart Harbinson, chairman of the WTO's agriculture negotiating committee, was not ambitious enough for the Americans and other farm exporters, but too bold for the Europeans and the Japanese.

In their reform, the Europeans seem to have given themselves room to reduce trade-distorting subsidies, perhaps by the 60% suggested by Mr Harbinson. They may also now be able to cut export subsidies, although the scope for this has been limited by their decision not to cut support prices for cereals. The trouble, however, is that the CAP reform was focused on domestic support, not trade: even if the reform leads to subsidy cuts, it says nothing new about tariffs or improving market access. For America and other big farm exporters, that is a big problem.

Market access, exporters are quick to explain, is the real key to freeing farm trade and helping poor countries. Robert Zoellick, America's top trade negotiator, also faces a cruder political calculus. He can persuade America's farmers to accept a cut in subsidies (which were increased generously last year) only if they see a big increase in opportunities to export. In Europe the issue is complicated not just by the CAP but also by the EU's policy on genetically modified crops (see article). But Mr Zoellick has difficulties elsewhere too. Developing countries with big rural populations, such as India and Indonesia, are loth to open their markets.

Even if Europe's proposals make little difference to the substance of the disagreements, they may change the political mood. By delivering reform, however compromised, and by reducing the trade distortions caused by the CAP, the EU seems to have won some goodwill in Geneva. Yet this could be squandered if the Europeans start using their limited reforms to demand too much from others.

A weak, overplayed hand

Guess what? Already Franz Fischler, the EU's agriculture commissioner, has declared: “Unilateral disarmament is not on.” Pascal Lamy, the trade commissioner, wants tighter rules for export credits and food aid, which Europeans claim the Americans use as disguised export subsidies; tougher rules on agricultural export monopolies, used by countries such as Canada; and, most important, protection for products from special geographic areas, such as Feta cheese, Kalamata olives or Parma ham. Other countries are furious about this last demand, which they regard as a new kind of protectionism.

Europe's farm deal may therefore go only a small way to closing the huge chasm in the agriculture negotiations. And farm trade is not the only item on the Cancun agenda. Market access for industrial goods is another thorny topic. Here too, the Americans decry others' lack of ambition. This time their gripe is not with Europe, but with developing countries. These claim that the Doha round's focus on development allows them to cut tariffs far more slowly than Mr Zoellick would like. At a recent meeting of trade ministers in Egypt he was blunt. If the Doha round founders on poor countries' intransigence over market access, America will turn to bilateral and regional deals.

Rich and poor are also divided over several new areas, such as competition and investment policy. At the start of the round trade ministers agreed that they would decide how to go about negotiations on these new subjects at Cancun. The Europeans, who are keenest, want wide-ranging talks. Some developing countries, particularly India, are worried about the WTO taking on these subjects, and want only narrow discussions.

Finally, developing countries want Cancun to honour the Doha round's supposed orientation towards their needs. They have specific demands in several areas: they want agreement on dozens of policies granting them “special and differentiated” treatment, and they want the implementation of previous trade agreements to be friendlier to the poor. Although talks among officials in Geneva have been going well, there may yet be troubles in Cancun.

Then there is access to generic medicines to fight diseases such as AIDS, which was supposed to have been agreed upon by the end of 2002. All WTO members agreed on a compromise text—bar America, which yielded to pressure from drugmakers. Most insiders think there will be a deal at Cancun, but only at the last minute.

Agriculture apart, none of these disagreements looks insuperable. However, time is running out. One sign of urgency is that officials in Geneva have had their holidays trimmed to a mere fortnight in August. But despite their sacrifice, the prospects for Cancun are at best uncertain.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

GM food and trade

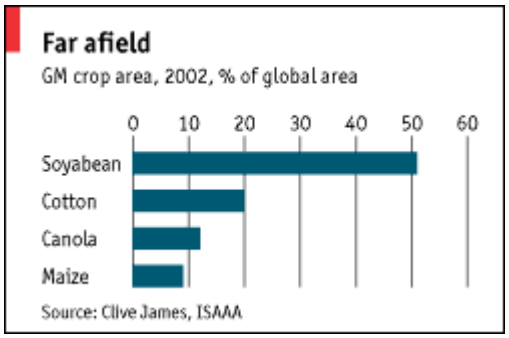
More trouble ahead

Jul 3rd 2003
From The Economist print edition

The European Union's new rules on genetically modified foods could worsen its trade dispute with America

MANY Europeans are profoundly suspicious of genetically modified (GM) food. Most Americans cannot understand what all the fuss is about—or why the Europeans will not buy stuff that America harvests (and eats) by the siloful. The two sides are further apart than ever. On July 2nd the European Parliament approved new regulations on GM food that seem likely to make it even harder to sell in the European Union than it is today. Later this month America, with a handful of allies, may well insist that the World Trade Organisation (WTO) establishes a panel to rule on the legitimacy of the EU's five-year-old moratorium on the approval of new GM crops.

The Americans claim that the moratorium violates WTO rules by creating a trade barrier without adequate scientific evidence that it is in the interests of either public health or the environment. The Europeans say that the ban will be lifted once they have put the finishing touches to their regulatory system. “Legally unwarranted, economically unfounded and politically unhelpful” is the European Commission's description of America's case.



Much the same could be said of the rules passed by the parliament this week. Like Australia and Japan, EU member states are already required to label foods as containing GM material under certain circumstances. The new rules have tightened these requirements and expanded their scope. Thus food must be labelled as GM if it has more than 0.9% of detectable GM content—ie, DNA or protein arising from genetic modification.

Under earlier labelling rules, derivatives of GM plants, such as corn oil or beet sugar, which are so refined as not to contain any such DNA or protein, did not require labelling. When the new rules come into effect later this year, even these derivatives will have to be labelled if they come from GM plants. But because they lack the telltale signs of genetic engineering, they will have to be accompanied by a paper trail, so that they can be traced right through the food chain. Curiously, the logic dictating that derivatives should be labelled will not apply to products made with genetically modified processing aids, such as GM enzymes or yeast. That leaves cheese, wine and beer, in which European exports are strong, untouched.

Consumer organisations and green groups are pleased with this week's result, and are celebrating the triumph of consumer choice over corporate interests. Further joy has come from another proposal approved by the parliament, which will allow member states to take “appropriate” measures to avoid the unintended presence of GM organisms in other crops. Of course, the easiest way will be to exclude them altogether.

Given the chilly reception that GM foods have received from Europeans, supermarkets and food processors have been reluctant to put GM labels on their products. Many have managed to get around this by buying their ingredients from non-GM suppliers. But the new rule on derivatives will affect a far wider range of products and, along with traceability requirements, will bring new costs to food processors, not to mention heightened risk of fraud.

The parliament's moves may well widen the transatlantic rift. Cliff Stevenson of Mayer, Brown, Rowe &Maw, a London law firm, points out that the new labelling rules may fall foul of WTO rules that oblige countries to provide equal treatment to “like products”, regardless of their method of production.

America has long argued that GM and non-GM versions of the same food are essentially equivalent. Labelling derivatives might therefore constitute an unfair barrier to similar products from GM producers, and so grounds for further complaint. In addition, the EU's new rules on traceability might be said to violate WTO regulations requiring member states to ensure that measures are “least trade restrictive”. C. Ford Runge, an economist at the University of Minnesota, points out that America might also be able to challenge the scientific underpinnings of the labelling rules, or the lack of them. Even if the EU moratorium is lifted swiftly, GM producers will still have cause for complaint.

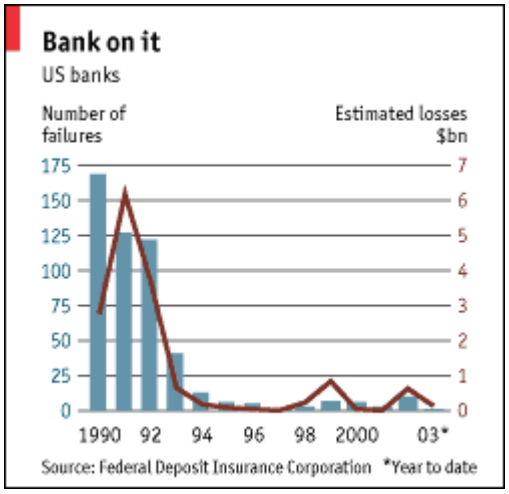
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

American banks

As good as it gets

Jul 3rd 2003
From The Economist print edition

Banks usually suffer after a recession. Why do America's seem so sound?



AFTER the recession of the early 1990s, hundreds of American banks went bust. The popping of the stockmarket bubble three years ago was followed by a mild recession and then only sluggish growth, and yet the number of banks that have gone to meet the great cashier in the sky can be counted on one person's fingers and toes. In 2002 only ten went bust, all small; so far this year, only one has failed (see chart). Bank shares have easily outperformed the broad market over the past three years. Regulators, who usually shout when they see trouble, have been remarkably calm.

As well they might be. Banks continue to rake in profits. In the first quarter the three biggest, Citigroup, J.P. Morgan Chase and Bank of America, made some $12 billion in total before tax. Financial firms now account for almost 40% of all corporate America's profits. After the recession of the early 1990s, their share fell to 15%; in the early 1980s, it was only 5%.

Granted, America's economy has not suffered as much as it did ten or 20 years ago. But the gloom has been long drawn out. So the vibrancy of the country's banks requires explaining. Some, recalling past losses in Latin America, on property and on oil, say that risk management has improved enormously. Ken Lewis, the boss of Bank of America, by some measures America's largest, says that this is true of his bank. Up to a point. In the first quarter, the bank wrote off $833m of loans that big companies were unable to repay. Something else must have gone right instead.

In its annual report, published on June 30th, the Bank for International Settlements (BIS), often called the central bankers' central bank, offers some explanations. Other recent recessions, the BIS points out, were all but engineered by the Federal Reserve, when it raised interest rates to reduce inflation. This time, the slowdown was caused by the end of an “investment-driven boom” (a bubble to you and me). The Fed's response has been to cut interest rates 13 times. Lower interest rates have made debts cheaper to service and kept many households and small firms from default.

Lower interest rates have fed another supporting factor, strong property prices. American mortgages are mostly long-term and fixed, with no penalties for early repayment. As long-term rates have come down, property has seemed more affordable. The result has been a housing boom that has kept consumption afloat, because people have felt richer.

Structural factors have also played their part, says the BIS. Chief among them is a gradual shift from bank lending to the capital markets, which has meant that banks carry less credit risk. The development of new financial instruments, such as credit derivatives, has also helped to shift risk from the banks to insurance companies, pension funds and others. At the end of 2002, banks had insurance against default covering $60 billion, equivalent to about 8% of their commercial and industrial loans. If borrowers default, money is still lost—but by sellers of credit protection, not banks. In addition, improved information technology has helped banks to manage their risks better; and the scrapping of a lot of regulations in the 1990s has allowed banks to become bigger, better capitalised and more diversified than they were.

Perhaps the most interesting part of the BIS's analysis is headed “vulnerabilities”. These include further

weakness in the economy, legal and reputational risks “related to their actions in the boom period of the late 1990s” (see article), and the possible fragility of credit-derivatives markets, which have yet to be fully tested. American companies still owe a lot of debt. Continued below-par growth would make this harder to repay. Higher long-term interest rates or credit spreads would also be awkward. Oh, and property prices could crash.

All true, and there is something else lurking. The lines of business that have done well in the past couple of years—mortgage lending, investing and trading in bonds, and underwriting bond issues—have been driven by low interest rates. But if money remains cheap, it is mainly because of worries about deflation. And that would not be welcome at all. Deflation erodes profitability and increases the real burden of debt, and so makes defaults more likely. Ask any Japanese banker. But higher interest rates would also be tricky for borrowers and banks. Savour this moment while it lasts.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Wall Street lawsuits

Dismissed

Jul 3rd 2003
From The Economist print edition

Wins in court for investment banks

NEW YORK courts are being kept busy by investors griping about goings-on in the heady late 1990s. On June 26th one judge said that 309 companies that burned brightly and briefly before burning investors must pay $1 billion to those who had bought their initial public offerings. Although claims against 55 investment banks that underwrote these IPOs are pending, judgments published on July 1st, from the same court, gave some idea of how they might be treated.

The judges threw out separate class-action suits against Wall Street banks. In one, an appeal of a case heard in February, the court found that there was inadequate evidence against the banks, even though regulators had unearthed analysts' e-mails describing companies they touted as “crap” and “junk”. The other judgment, involving Merrill Lynch and Henry Blodget, once its star internet analyst, probably matters more, both for the forceful language of the judge, Milton Pollack, and because Mr Pollack is overseeing another 25 class-action suits against investment banks.

Judge Pollack is no neophyte in securities law. At 96, he is the oldest judge still sitting, and first became a lawyer in 1929—living evidence, perhaps, that history is cyclical rather than linear. He presided over the 1989 settlement with Drexel Burnham Lambert, an investment bank that went bust as a result, in another era plagued by greed and sharp practice.

The judge's experience has not warmed him to what he regards as frivolous litigation. Calling the plaintiffs “high-risk speculators” who should have known what they were taking on, he said: “[They] would have this court conclude that the federal securities laws were meant to underwrite, subsidise, and encourage their rash speculation in joining a freewheeling casino that lured thousands obsessed with the fantasy of Olympian riches, but which delivered such riches to only a scant handful of lucky winners.”

The plaintiffs may contest his ruling. Mr Blodget, after all, has paid $4m in fines and been banned from the securities industry. Still, Mr Pollack's judgment is refreshingly clear. Is he a believer in the principle of *caveat emptor*? “You're 100% right.”

A good week, then, for Wall Street's finest. Ten big banks have already had to stump up $1.4 billion (of which Merrill paid $100m) in a deal with regulators and had feared far worse. The question now is how far Mr Pollack's ruling will influence other cases. He sees “a very substantial precedent for cases with similar facts”. The degree of similarity remains to be established; but the judge threw out another case against Merrill the very next day.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Fund management in Italy

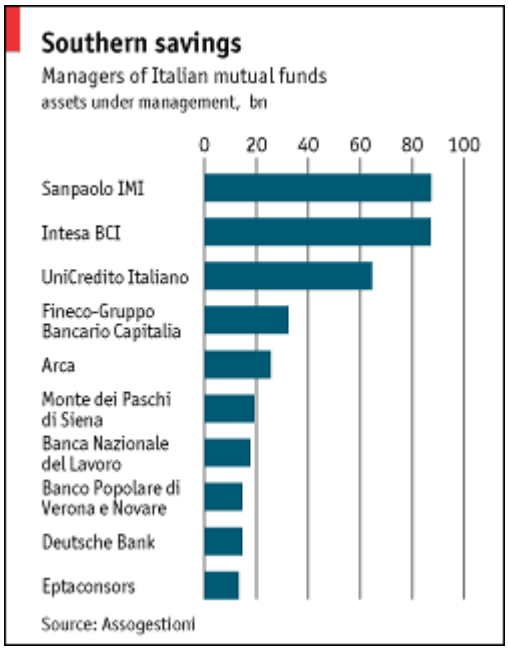
Dependency culture

Jul 3rd 2003 | MILAN
From The Economist print edition

Italy could do with truly independent mutual funds

"THE events... allow us to hope that a new important phase of maturity for Italian capitalism has begun," proclaimed a recent note on the website of Assogestioni, Italy's investment-management association. The "events" were not as dramatic as all that. At the annual general meeting of Telecom Italia in May, fund managers had criticised the company's merger with its parent, Olivetti, a heavily indebted telecoms group. But the revolt stopped short of outright opposition to Telecom Italia's management. When foreign shareholders voted against the merger, the fund managers merely abstained.

Still, in Italy even a token protest is noteworthy. Italian fund managers hardly ever take issue with company bosses at shareholders' meetings. That is a pity: given the size of Italy's mutual-fund industry, they could be a force for good in a country where corporate governance is notoriously weak.



Italy's mutual-fund market is the second-biggest in continental Europe, after France, with about *euro*500 billion ($525 billion) under management at the end of 2002. It took off in the late 1990s, as interest rates tumbled and government bonds lost their appeal. Between 1997 and 1999, about *euro*280 billion was shifted out of government paper into actively managed funds, says Leonardo Rubattu of Fox, Pitt-Kelton, an investment bank. Banks were keen to encourage investors to switch, because the fees on such funds are ten times those on custodial accounts for government bonds. The growth of mutual funds has helped banks to lift their return on equity from almost zero to 12%.

If mutual funds are so important, why do they not put more pressure on company boards? The main reason, says Luigi Spaventa, former chairman of Consob, the securities-market watchdog, is the lack of private pension funds and the control of mutual funds by banks, which are "engaged in complex relationships with listed companies." The bulk of the mutual-fund industry, including eight of the top ten firms, belongs to banks.

Assogestioni is aware that banks' dominance gives rise to a conflict of interest. Mutual funds might be chary of criticising their parent banks' clients, or they may even feel obliged to invest in their shares. The association points to a 1998 law that requires mutual funds to be run as stand-alone operations. In 2001 Assogestioni itself tried to strengthen this separation, by drawing up a code of conduct for mutual funds and their owners. It says 82% of its members adhere to the code.

Sceptics are not convinced. "I am not sure these Chinese walls work very well," says Pierluigi Parmeggiani, a consultant. There is always the risk that an asset manager will be swayed by the interests of its parent bank. In a survey last year, Claudio Scardovi of Mercer Oliver Wyman, a consultancy, found that almost all the banks he visited would be more profitable if they were to outsource asset management. "But having an asset manager captive," says Mr Scardovi, "may be a way of keeping control of the real economy."

Banks might prefer control to profit because they, in turn, are often controlled by charitable foundations, on whose boards sit cronies of local governments. Silvio Berlusconi's government is currently trying to pressure foundations to sell their stakes in banks. However, his motive may have as much to do with

politics as with a desire for better corporate governance. Three of Italy's four biggest banks are linked to the centre-left opposition, and only one to Mr Berlusconi's friends on the right.

A second reason for the fund managers' timidity is that, in Italy, minority shareholders are used to being brushed aside. Few companies are genuinely public. Last year only 32 of the 275 Italian companies listed on the Milan stock exchange were not controlled by a majority shareholder or by a small group acting together, putting minority shareholders in a weak position.

For all his association's stirring words, Fabio Galli of Assogestioni defends fund managers' hands-off approach. Mutual funds are not the watchdog of the market, he says. Participating in AGMs and casting votes is costly: Italian voting procedures are cumbersome. Moreover, Italian mutual funds tend to be highly diversified, which makes it hard to keep a close eye on every share in their portfolios.

Even so, minority shareholders are not helpless. Their rights were strengthened by a 1998 law that, for instance, entitled them to elect independent directors to company boards. That should give them more leverage than the usual threats to sell shares. Holding a better-performing stock beats selling a poor one.

Is the Italian set-up really so bad? In other countries, such as France and Germany, banks also own much of the mutual-fund industry. Yes, but France (especially) is no role model for the treatment of minority shareholders; and in neither France nor Germany are banks controlled by political foundations.

Italy, says Carlo Alberto Carnevale Maffé of Bocconi University in Milan, does not have the mature financial markets and large private pension funds of America or Britain, and so cannot be judged by the same standards. “Rules are different here, but it works,” he says. Imagine what Italy might achieve if it worked even better.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

A saving grace

Jul 3rd 2003
From The Economist print edition

Japanese households have lost their appetite for thrift

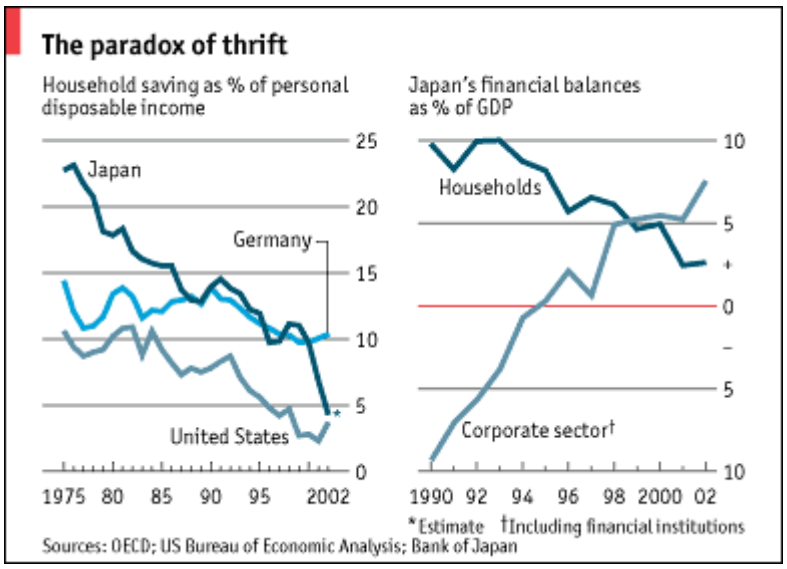
Get article background

THE profligacy of American households is legendary: their eagerness to spend and spend has been the main motor of the American economy in recent years. The Japanese, in contrast, are renowned for their thrift. It is often claimed that one reason for the country's economic stagnation is that consumers, fearful of deflation and unemployment, insist on keeping their wallets firmly shut. Yet it is a myth. Although in the early 1980s Japanese households were among the world's champion savers, they are so no longer. Indeed, their saving rate is now roughly the same as that of spendthrift Americans.

Recently revised figures show that Japanese household saving fell from 23% of personal disposable income in 1975 to 14% in 1990, and then to 6.9% in 2001 (the latest official figure). Osamu Tanaka, an economist at Morgan Stanley, thinks the ratio fell to 4% last year and to a piffling 2% in the first quarter of 2003. If so, Japan's household saving rate is now below America's (at present 3.5%) for the first time in 50 years. It is also well below rates in the euro area, which are typically above 10%.

Thanks to the decline in saving, Japanese consumer spending has outpaced the growth in incomes. Over the past couple of years it has continued to rise even as incomes have shrunk. Such a sharp fall in saving seems puzzling: a popular argument has it that deflation causes people to put off buying things in the expectation that they will be able to get them more cheaply next year. In addition, Japanese households have suffered from a slump in asset prices, and thus a loss of wealth. So they should be saving more to rebuild their nesteggs. And there is a third reason why you might have expected higher, not lower, household saving in Japan: the big increase in government borrowing in the past decade. According to a theory known as Ricardian equivalence, households should now be anticipating higher future taxes to repay the extra government debt, by saving more today. Yet ordinary Japanese are saving less.

Why? Perhaps the best explanation for the fall in saving over the past two decades lies in a theory called the life-cycle hypothesis. This supposes that during their working years individuals spend less than they earn, and thus accumulate wealth, which they plan to draw on once they retire. So the more retired people there are in relation to the number of workers, the lower the saving rate will be. The ratio of Japanese aged over 65 to those of working age rose from 15% in 1980 to 28% in 2000. It is forecast to increase to 38% by 2010 and to 50% by 2020.



A study by Peter Morgan, an economist at HSBC, finds that this demographic shift can explain half of the fall in Japan's saving rate over the 20 years to 2000. Much of the rest of the decline may be related to inflation. When inflation soared in the 1970s, the erosion of the real value of wealth prompted households to save more to rebuild their assets. As inflation fell, they needed to save less to maintain their real wealth.

But neither demographic change nor inflation can explain the steep fall in the saving rate since 2000. One possible cause, suggests Mr Morgan, is the maturing in 2001 of a lot of high-yielding, ten-year postal savings deposits. As households replaced these with assets yielding lower returns, their interest income fell. If they save largely out of investment income and consume largely out of their wages, this could reduce the saving rate.

Another clue is that most of the fall in the saving rate is accounted for by those over 60. The elderly, who often have fixed incomes, no debts and hold their wealth mainly in bank accounts, are the one group with nothing to lose from deflation. Their money goes further, so they spend more.

Starving the piggy bank

The recent plunge in the saving rate could be reversed over the next few years, but the long-term trend is surely downwards, because Japan's population will continue to age. Mr Morgan reckons that the saving rate could drop by another five percentage points from its 2001 level, to 1.7% by 2010. In contrast, many economists forecast that over the next few years America's saving rate will rise to at least 6% as consumers are forced to trim their debts.

Japan's high rate of saving used to be the main reason for its large current-account surplus. (The current-account balance is equal to the gap between domestic saving and investment.) So if Japanese households continue to save less, will Japan's current account move into deficit? Not necessarily. That depends on total national saving—ie, saving by companies and the government as well as households.

In recent years the government's hefty borrowing has contributed to a fall in national saving. However, the behaviour of households and government has been offset by a marked increase in saving by firms. The corporate sector is running a big financial surplus, because firms have slashed investment and started to repay debts. Non-financial companies and financial institutions together ran a surplus of 8% of GDP last year (see right-hand chart). In 1990 they were net borrowers to the tune of 9% of GDP. As a result, Japan's total national saving has stayed high relative to investment, keeping the current account in surplus.

But what if business investment rebounds? Would the current-account surplus then vanish? The answer is not a simple Yes, because changes in the financial balance of one sector can cause offsetting shifts elsewhere. For instance, the fall in borrowing by firms in the recent past has helped to push down interest rates; lower interest income has then reduced household saving. When companies begin to borrow again, interest rates will rise, possibly boosting household saving. Moreover, once firms have finished cutting costs and reducing debts, there will be less need for a large budget deficit to support demand. A stronger economy would lift government revenues, narrowing the deficit. So total national

saving might not shrink much. It could be premature to say *sayonara* to Japan's current-account surplus.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Unmanned aerial vehicles

Suspended animation

Jul 3rd 2003
From The Economist print edition

AP

Unmanned craft loitering in the stratosphere may soon supplant satellites

HYPERSONIC drone aircraft that could bomb any target in the world from a base in America recently grabbed headlines in the *Guardian* and other newspapers. But fast and flashy is no substitute for slow and steady. UAVs (unmanned aerial vehicles) that can loiter over the same spot for months are likely to be of more lasting military and commercial significance.

They are also hard to build. The most advanced prototype of such a UAV, a solar-powered craft called *Helios*, was destroyed on June 26th when it crashed into the Pacific. The cause of the crash is still unknown, although turbulence is thought to have been a factor.

Helios was built by AeroVironment, a Californian company that specialises in innovative engineering. (Its founder, Paul MacCready, built the first human-powered aeroplane.) Unfortunately, the recent bad luck of NASA, which manages the programme, seems to have rubbed off—and the speed with which an accident investigation team was assembled is testimony to NASA's current investigative fervour. Unlike the ill-fated space shuttle *Columbia*, however, *Helios* was exactly the sort of programme that NASA should be funding—an unmanned craft that is pushing technology to its limits.

The ultimate aim is to create a pilotless aircraft that can loiter over a particular spot on the ground, at an altitude of around 20km, for up to six months. This would allow the craft to serve as a “geostationary” communications relay, substituting for satellites that now do the job. Being closer to the ground than such satellites (which are in orbit almost 36,000km away), means that the transmitters and receivers involved could be less powerful, and more information could be transmitted at far less cost. Hovering UAVs could also serve as sentries, watching over a country's coastline for smugglers and terrorists, and as military reconnaissance platforms. And both communications and reconnaissance UAVs would be significantly cheaper to build and launch than their satellite equivalents.

But there are still many hurdles to be jumped before solar-powered UAVs can loiter for months at a time. Most observers estimate that such flight durations are at least a decade away. When it crashed, *Helios* was preparing for a flight of only 40 hours. Nonetheless, AeroVironment is planning to start a commercial, UAV-based communications relay service within three years, according to Stuart Hindle, a vice-president of both AeroVironment and its subsidiary, SkyTower, which is devoted to the communications project.

By that time, Mr Hindle says, SkyTower should be able to make flights of several weeks' duration over the wealthy markets of North America and Europe. (Longer flights will be possible over countries near the equator, because they are sunnier and there is less wind.) This, he says, is long enough to make it

possible to provide a broadband service that would be cost-competitive with today's land and satellite-based systems. A single UAV could provide connections of at least five gigabits per second to around 200,000 subscribers, and a rotating fleet of them would provide continuous coverage.

Although broadband communications may be the first UAV technology to go commercial, the craft are also appealing as “virtual” mobile-phone towers, which could provide extra capacity when a crowd migrates to a normally under-populated area (as in the recent Glastonbury music festival, when more than 100,000 people flocked to a field in the British countryside). Indeed, SkyTower successfully tested such a system in 2002, in co-operation with Japan's Ministry of Telecommunications. Armed forces around the world are also interested. UAV-based systems could provide a battlefield with temporary communications coverage.

Sunshine on my shoulders

Long-duration UAVs depend on sunlight. All the existing models are pulled around the sky by electric motors, and the electricity to do the pulling has to come from somewhere. However, blanketing a craft's wings with photo-cells that convert sunlight into electricity is not sufficient, as night inevitably follows day. The most important trick is to find an electricity-storage system that is light and efficient enough to power a craft through the hours of darkness. If that system can be fully re-charged during the day, then a UAV could fly indefinitely. The problem is that re-chargeable systems tend to be too heavy. To solve this, AeroVironment has turned to fuel cells, which work by combining hydrogen and oxygen to produce water and electricity. The most appropriate sort of fuel cell, called a closed-cycle cell, uses electricity from solar panels to break its water up into hydrogen and oxygen during the day—in effect, re-charging itself. But closed-cycle systems are, for the moment, too heavy to be feasible in windy, sunless high latitudes. So *Helios* and its immediate successors will rely on open-cycle systems that bring hydrogen with them and take oxygen from the air. Such fuel cells can, however, power a UAV for only a couple of weeks, as the hydrogen they carry eventually runs out.

According to Chris Kelleher, a project manager at QinetiQ, a British defence contractor that is building a UAV called the *Zephyr 3*, another option worth examining is super-efficient batteries, probably derivatives of the lithium-based batteries used in mobile phones. As Mr Kelleher points out, the distinction between batteries and fuel cells is a bit blurred: both rely on combining chemicals to produce electricity.

One way to avoid the problem altogether, says Dyke Weatherington, an official responsible for UAV planning at America's Department of Defence, is to turn to nuclear power. Like that on satellites, this would rely not on nuclear fission, but on heat generated by radioactive decay, which would be converted into electricity by devices called thermocouples.

Some people in the American defence establishment see this as the ideal solution, he says, though he recognises that it is fraught with environmental and political risks. And unlike Mr Hindle and Mr Kelleher, who seem convinced that propellers are the best way to pull UAVs through the thin air at high altitudes, Mr Weatherington reckons that the next five years may also see the development of new sorts of low-fuel-consumption jet engine.

QinetiQ energy

The main competition to fixed-wing UAVs will come from unmanned airships. Although airships would be less useful for reconnaissance missions that require mobility, they might serve as communications relays. Indeed, QinetiQ is combining the two, after a fashion. In a few weeks' time *Zephyr 3* will be lifted to a height of 9km by a helium-filled balloon, before being launched on a mission intended to break *Helios*'s record for high-altitude flight, which stands at 29km. (The balloon will then follow *Zephyr 3* up, so the mission could also break the altitude record for a manned balloon.)

As Mr Kelleher points out, airship technology is less mature than that of UAVs. Although the buoyancy of a bag full of helium allows an airship to carry a larger payload, that bag is also buffeted by the winds of the stratosphere, which means that an airship has to have a more powerful propulsion system. Leland Wight, a programme manager for high-altitude airships at Boeing, says that the biggest engineering challenge is to get the balloon, which is only partially inflated at ground level, up to its operational altitude without its getting tangled up.

One benefit of the greater carrying capacity of airships is that they will be able to use less exotic power sources than fixed-wing UAVs. Mr Wight says that Boeing is planning to employ an internal-combustion engine powered by a special fuel to supplement the solar cells. In competition with Lockheed Martin and a third team led by Aeros, an airship company based in California, Boeing is developing a prototype for America's Missile Defence Agency. This should fly in 2006. Mr Wight says Boeing is especially interested in the possibility of using airships as communications relays. But, if SkyTower's plans go well, UAVs will enter the market a lot sooner than airships.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Clandestine UAVs

A golden eye in the sky

Jul 3rd 2003
From The Economist print edition

A stealthy drone that flies like an aeroplane and takes off like a helicopter

Ready for take-off

AMERICA'S armed forces sometimes ask for very strange things. So, when DARPA, the Defence Advanced Research Projects Agency, asked Aurora, a company based in Manassas, Virginia, to design an unmanned aerial vehicle that was quiet, small, could fly for several hours on autopilot, and could deliver two cylinders the size of Coke cans to a distant location, Aurora happily obliged.

The result, called GoldenEye (they take their James Bond seriously, it seems), is scheduled to make its first test flight in the next couple of weeks. The craft is a stubby cylinder, 1.7 metres tall, with wings that measure 3 metres from end to end. Unladen, it weighs just under 70kg, and it can carry an additional 20kg of fuel and payload, including cameras and the mysterious cylinders.

Carl Schaefer, an engineer at Aurora, says that the design of GoldenEye is unique. Its engine, known as a “ducted fan”, is a propeller shrouded within the cylinder. This makes it quiet—at a distance of 150 metres it is no louder than a nearby conversation. It also makes it safe to use the craft in crowded, urban areas, which should, in turn, make GoldenEye appealing to police forces (who have to worry about the safety of civilians) as well as the armed forces.

Another of GoldenEye's features is vertical take-off. Its wings are not rigidly attached to its body, but rotate independently. This allows it to go straight up like a helicopter, and then to level off into horizontal flight. Once level, it can fly at 260kph for up to four hours.

Mr Schaefer says that the transition from vertical to horizontal flight is the trickiest bit to manage, because the craft is aerodynamically unstable while it is flipping over. The trick is done by a computerised control system that rapidly adjusts the craft's various flaps to keep it flying. The same system can navigate the craft to a preselected point automatically, thus minimising radio transmissions and allowing it to work clandestinely.

Not everything about GoldenEye needs to be secret. Ed Smith, Aurora's director of business development, is optimistic about the prospects of selling it to customers other than the federal government. The firm is developing a half-scale commercial version, which weighs just over 7kg. Although it can carry a payload of only a couple of kilograms, this is sufficient to accommodate a camera. Mr Smith expects that law-enforcement agencies will be big customers for this small version. It could, for example, allow coastguards to have a bird's-eye view of a ship before boarding it at sea. And, at a mere $50,000 a pop, it will, Aurora hopes, be cheap enough for local police forces to afford.

The coppers, though, will be unable to receive deliveries of mysterious cylinders. That privilege will be reserved for America's spies. But the spooks should now be able to rest a bit easier in the knowledge that, if they get thirsty, the best Coke delivery system that money can buy is ready to serve them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Medicine

Hard as nails

Jul 3rd 2003
From The Economist print edition

It may be possible to detect osteoporosis by looking at fingernails

AS BRITAIN'S chancellor of the exchequer discovered when he entered office, fingernails can reveal a lot about a person—whether they are airbrushed works of art, nicely trimmed, dirty or, as with Gordon Brown, well bitten. Now Mark Towler, of the University of Limerick, in Ireland, is suggesting that nails might reveal not only a person's state of mind, but his state of body, too.

It all started when a group of patients with osteoporosis noticed that their fingernails became stiffer when they received treatment for their disease. Some scientists then wondered whether the strength of a person's fingernails might give any indication of whether or not he was suffering from osteoporosis. Dr Towler set about measuring the strength of fingernails by dropping a small, diamond-tipped needle on to them. The deeper the needle penetrated, the more flexible the nail. (The squeamish may wish to note that this test can be done using a fingernail clipping.) In a test of 30 people, Dr Towler found that the nails of those with osteoporosis were significantly softer than those of people without it. In other words, needle-dropping, or “nano-indentation” as he prefers to call it, could be used diagnostically.

At the moment, osteoporosis is diagnosed using X-rays, which measure the density of bone. In the past, it was widely believed that a decrease in bone density was the main cause of osteoporotic fractures. But some of those who suffer such fractures have exactly the same bone density as people who do not. Researchers now believe that collagen, the structural protein that gives bone its flexibility, also plays an important part in osteoporosis. That makes sense, because the more flexible a bone is, the less likely it is to break.

Dr Towler thinks it likely that changes in the amount of collagen are reflected in changes in similar structural proteins, such as keratin, from which fingernails are made. Hence his observations. Admittedly, they are preliminary and require replication in a bigger sample for confirmation. But if they are confirmed they could form the basis for a cheap and simple test for osteoporosis which could, as it were, nail the disease down quickly.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Quarks

Five alive!

Jul 3rd 2003
From The Economist print edition

An odd, new subatomic particle, the “pentaquark”, has been found

JAMES JOYCE would have been delighted. Quarks, one of the basic building-blocks of matter, were named in the 1960s after a line from his novel “Finnegans Wake”—three quarks for Muster Mark!—because they were then thought to come in three types (the number is now known to be six). Protons and neutrons, however, do consist of three quarks each. And physicists have now discovered a particle that is made of five quarks—a bit of a promotion for Muster Mark.

The pentaquark, which has been dubbed “theta-plus”, was found by a collaboration at the SPring-8 accelerator in Hyogo, Japan, which reports its results in the latest issue of *Physical Review Letters*. The collaborators found the particle in three-year old data, after they were told what to look for by Dmitri Diakonov, a theoretician at the Petersburg Nuclear Physics Institute, in Russia.

After word of the SPring-8 results started spreading among physicists, the theta-plus was also found in experimental data at the Jefferson Laboratory in Newport News, Virginia, and at the Institute for Theoretical and Experimental Physics in Moscow. These independent confirmations of the result, says Kenneth Hicks, a member of both the Japanese and American teams, is proof that the theta-plus is a real particle and not an artefact of the data.

All three experiments work in roughly the same way. Everyday particles (the Japanese and Americans use electrons; the Russians, protons) are boosted to high speeds in a circular accelerator. This causes them to emit gamma rays, which are then used to bombard atomic nuclei (carbon, hydrogen and xenon respectively) that have been set up as targets in the accelerators. When the gamma rays interact with particles in the nuclei, they create short-lived pentaquarks. When these in turn decay, they do so in a way that, Dr Hicks says, identifies them uniquely. It is the particles produced in this decay that actually give the game away.

Dr Diakonov's theory predicts that nine other pentaquarks should make up a “decuplet” of the beasts. Whether he is right remains to be seen. But in any case, the zoo of particle physics has just acquired at least one new animal.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Planet hunting

Just like home

Jul 3rd 2003
From The Economist print edition

A solar system like the sun's?

THE search for a solar system resembling the sun's has come up with a candidate. This week, a team of British, Australian and American researchers led by Hugh Jones of Liverpool John Moores University, in England, announced the discovery of a Jupiter-like planet in orbit around a star known as HD70642, about 90 light-years away from Earth.

These days, planets going round stars other than the sun are two a penny. What is significant about this one is that it moves in a nearly circular orbit some distance from a parent star that is similar to the sun, without any other big planets in closer orbits. That leaves room for small rocky planets to live between the big planet and its star, just as Mercury, Venus, Earth and Mars live between Jupiter and the sun.

Before any were actually discovered, planetary systems around other stars were expected to be broadly similar to the sun's solar system. So it came as something of a surprise when the first were found to be completely different. In some, Jupiter-like gas giants (which are the only planets detectable at such distances) move in highly elliptical orbits, so that their distance from their parent stars varies enormously. In others, the gas giants are close to their stars, in contravention of what had been the accepted model of how solar systems are formed. Indeed, it had begun to look as though it was the sun's system that was the odd one out.

This latest discovery does not prove that this conclusion is wrong—after all, about 100 solar systems are now known, and none but this new one is like the sun's. It should, however, prevent theorists from rewriting the rules of planetary formation too hastily.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

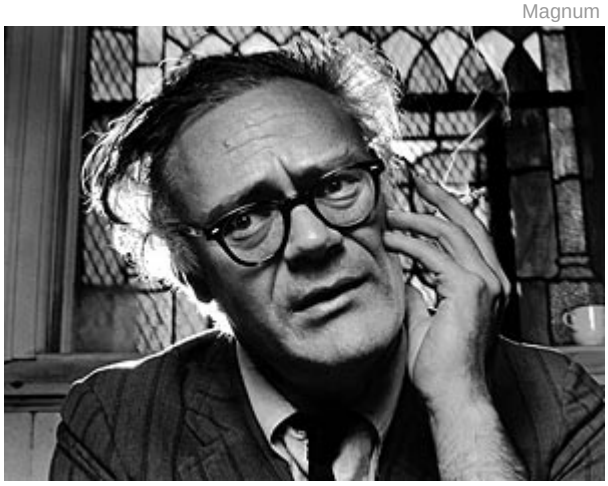
About sponsorship

Robert Lowell

America's Shelley

Jul 3rd 2003
From The Economist print edition

Magnum



Robert Lowell's "Collected Poems" are finally being published, more than 25 years after his death. They should garner new readers for this prince of poets

WHEN Robert Lowell died in 1977 at the age of 60, he had long been regarded as America's greatest post-war poet. The scope and ambition of his best work was unrivalled. Yet, from then on, his reputation suffered something of a decline. The imperious, brahminic Lowell appeared to be out of key with the times. American poetry had begun to fissure into a rainbow coalition of voices—gender poetry, post-modern, native-American. To some, they were all equally worthy. Could a man such as Lowell, whose forebears came over on the *Mayflower*, whose family included a president of Harvard and, in 1880, a minister to England, and whose verse is full of difficult allusions to the European classics, continue to be poetry's standard bearer in an age which no longer valued verbal complexity?

This may be one reason why it has taken more than a quarter-century to publish Lowell's collected poems. Why such tarrying? The principal editor of this book is a poet and university lecturer named Frank Bidart. A former graduate student of Lowell's at Harvard, Mr Bidart was appointed his literary executor after the poet's death. He knew Lowell for the last 11 years of his life, and the task of nursing this book through to publication has been a mix of love and duty—and a project of enormous complexity. Why so difficult? Because Lowell was never satisfied with himself. He wrote and re-wrote his poems throughout his life. He often published different versions of the same poem in different places. Mr Bidart had first to find all these versions, compare them, and then print the one he deemed most successful.

Then there was the question of notes. The book needs its voluminous explanatory notes. Without them much of Lowell's work would simply not be understandable. But there has also been a certain amount of foot-dragging on Mr Bidart's part, as he readily acknowledges. "Yes, you have to build into this my own neurosis," he says. "The publishers had to drag it out of me. I didn't think I'd finish it in my lifetime. There were lots of moments when I felt I was losing him all over again. I had a dread of its being over. You see, I adored him, I felt in his debt to an immense degree, and I wanted to do something to honour him, commensurate to his work."

That debt has now been discharged in full. So how do we rate our hero today? Lowell was writing verse from the late 1930s until a few days before his death. The poetry of the first decade, such as "The Quaker Graveyard in Nantucket", is remarkable for the vehement intensity of its rhetoric, the rhythmical

compulsion of its lines, which are loaded, if not overloaded, with shimmering metaphor. By the 1950s, he was striving for a plainer and more directly conversational manner and a less clotted language. The effort paid off, particularly, in “Life Studies”, a collection, published at the end of the decade, which combines poems with autobiographical prose to great effect.

It was around this time that the adjective “confessional” began to be used to define Lowell's verse. Lowell hated the term because it smacked of self-indulgence and a lack of discipline. But it stuck, and it continues to have a certain appropriateness. The poet's three marriages—including to Elizabeth Hardwick and Caroline Blackwood, the second Mrs Lucien Freud—were all tumultuous, and he suffered repeatedly from mental illness. Although this eased when he was treated with lithium in the late 1960s, the intensity of the experience continued to affect his writing. Even when he is examining the glamorous dangers of American power, or alluding to the Bible or Herman Melville, it is the drama of Lowell's own life which tends to be the focus of the poems.

“Imitations”, which succeeded “Life Studies” in 1961, managed to achieve a better balance between Lowell's urge towards self-dramatisation, which is always present in his work, and the rendering of a world outside himself. Far from being straightforward translations, “Imitations” is a free reinvention—a brilliant embellishment, even—of the works of other poets, including Rimbaud, François Villon and Boris Pasternak.

The poems are marked by that same vehemence and urgency that characterise so much of Lowell's other work. But he also makes a genuine effort in “Imitations” to inhabit the shades of others. Nowhere is this more successful than in his renderings of the 19th-century French poet, Charles Baudelaire. The baleful, self-flagellating Baudelaire and the fiercely depressive Lowell were evidently kindred spirits, and Lowell re-imagined him with haunting authority in such poems as “Spleen” and “To the Reader”.

Four years before his death Lowell also published a controversial collection of unrhymed sonnets called “The Dolphin”, which included extracts from personal letters addressed to him by his second wife, Elizabeth Hardwick. Although the ties between the two were sufficiently strong that Lowell returned to her in the last months of his life, he was roundly condemned for exposing—and exploiting—the details of his personal life in the service of his art.

For all his failings as a human being, Lowell remains a titan, and an exemplary figure to anyone who has a serious interest in the art of poetry. What can never be denied is the range, gravity and intellectual reach of his work, and the fact that, from first to last, he regarded poetry a sa task of the utmost seriousness. As his “Collected Poems” show, there were no half-measures with Lowell.

Collected Poems.
By Robert Lowell. Edited by Frank Bidart and David Gewanter.
Farrar, Straus & Giroux; 1186 pages; $45.
Faber and Faber; £40

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Polish Jews

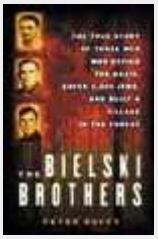
A blessed band

Jul 3rd 2003
From The Economist print edition

JEWS in eastern Europe faced four enemies during the second world war. There were the Nazis, who wanted to herd them into ghettos and concentration camps, and ultimately to the gas chambers. There were gentile locals, some of them pro-Nazi, others anti-Semitic. There were the Soviet forces, nominally opposed to Hitlerian racial policies, but in practice deeply suspicious of Jewish self-organisation and identity. Finally there were the enemies within: Jews who collaborated or gave way to indiscipline or selfishness.

The Bielski brothers, and the 1,200 Jewish partisans they led in the Polish-Belarussian forests in 1942-44, faced all four at once. The main enemy was the Nazis. What started as survival became resistance and then counter-attack. The forest *shtetl* housed tailors, cobblers, smithy, armoury and tannery. But to fight the Nazis they needed food. That came from the hapless local peasantry, usually at gunpoint. Coping with the Soviets, by contrast, required brains. Stalin and his generals wanted partisan fighters to be loyal Communists, untainted by religious or nationalist feeling. Tuvia Bielski, the eldest of the three brothers running the Jewish resistance, was wily enough to feign loyalty, while focusing on the main job: saving Jews and killing Germans.

The Bielski Brothers
By Peter Duffy



HarperCollins; 320 pages; $25.95. Published in Britain as "Brothers in Arms"; Century; £16.99

Buy it at
Amazon.com
Amazon.co.uk

When a Soviet commander visited the non-combatant bit of the outfit, which sheltered women, children and the elderly who had escaped from ghettos in the surrounding region, he remarked on some Jews studying the Torah. The quick-witted Bielski told him they were studying party history. The visitor roared with approving laughter; shortly afterwards the Bielski civilians gained a special status as a quartermaster corps, thus forestalling a merger with less sympathetic gentile units.

A task that tested even the Bielski guile was keeping the forest Jews united. Justice was crude, delivered on more than one occasion by summary execution. Such harsh measures may have been the price of a stunning survival—or they may have reflected Bielski's volatile temperament, exhaustion or other shortcomings.

Peter Duffy has chosen a fascinating story. Unfortunately, his glib tone betrays the heroism of his subjects. His tunnel vision emphasises the aspects of the story most suited to a mawkish film, and ignores or trivialises the moral complexities and dilemmas of resistance, leadership, loyalty and collaboration in wartime Europe.

For example: what about pork? Much of the food available to be looted was non-kosher. Did the Bielski's pious Jews ignore dietary rules? The tiresomely chatty prose skates round this: butchers in the forest settlement, as they made sausages and smoked meat, “strived to maintain” the kosher laws, he writes. With what result? Mr Duffy leaves that question, like so much else, in schmaltzy soft focus.

The Bielski Brothers.
By Peter Duffy.
HarperCollins; 320 pages; $25.95. Published in Britain as “Brothers in Arms”; Century; £16.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Elizabethan history

Sir Walter Mitty

Jul 3rd 2003
From The Economist print edition

SIR WALTER RALEGH shot to fame in the 1580s as a poet, wit, naval commander and puddle-coverer-in-chief to Queen Elizabeth I. His downfall, by contrast, was slow and inglorious.

Though briefly imprisoned in the Tower of London for upsetting the queen, he wormed his way back into her good books, and in 1595 was put in command of a treasure-seeking expedition to South America. By 1603, with James I on the throne, Ralegh was in the Tower again, this time on a trumped-up charge of treason. There he remained until 1616, busying himself with his “History of the World” and with petitioning the king, begging for a second chance. His grovelling paid off, and he was released to lead another expedition to the New World. The expedition didn't go well, though, and Ralegh's enemies had no trouble persuading the king, who was already fed up with this arrogant chancer, to order his arrest as soon as he returned from the Orinoco.

Ralegh's Last Journey: A Tale of Madness, Vanity and Treachery
By Paul Hyland

HarperCollins; 242 pages; £14.99

Buy it at
Amazon.co.uk

Ralegh was duly escorted from Plymouth to London in the summer of 1618. But what should have been a quick trip wound up taking nearly three weeks and was, as Paul Hyland makes clear in his engaging account, more than a little fraught. High treason? More like low comedy.

Desperate to buy time, Ralegh simulated sickness by secretly quaffing “vomits” and emetics. Cranking up the theatrics, he further spooked his captors by crawling naked around his inn bedroom, “scratching and biting” the furniture. He paid a French doctor to apply foul lotions to his body, in order to bring out violent boils and rashes. “We shall laugh well one day, monsieur,” Ralegh quite incorrectly predicted, “for having thus cozened and beguiled the king, his council, and the Spaniards and all.”

Mr Hyland, a poet and travel writer, narrates the whole ignominious episode with aplomb. He has drawn on the writings of Sir Lewis Stucley, the man who arrested Ralegh and led him back to London and to the scaffold. The fact that Stucley was Ralegh's cousin is by no means the strangest twist in this tale. After Ralegh's execution, he was branded “Sir Judas Stucley” by an outraged public, and the king himself is reported to have said to him: “Ralegh's blood be on thy head.” Stucley subsequently fled to the island of Lundy, where he went mad and died alone.

Ralegh's Last Journey: A Tale of Madness, Vanity and Treachery.
By Paul Hyland.
HarperCollins; 242 pages; £14.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Mormons who murder

Hells bells

Jul 3rd 2003
From The Economist print edition

JON KRAKAUER set out to write a book about how the Mormon Church is dealing with its past. He tells how its most influential prophet, Joseph Smith, had a predilection for “spiritual marriage” with teenage girls that led to the church's enthusiasm for polygamy in the 19th century. But part way through, Mr Krakauer changed tack. Much of the book is concerned with the murder of a woman and her baby daughter by her two Mormon brothers-in-law. They believed God had instructed them to kill her.

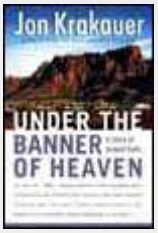
The result is a powerful portrait of how two seemingly ordinary Americans became murderers. It describes the peculiar world of Mormon fundamentalists—extremists within the church, still “marrying” many women and breeding vast families, and loathing government, even while accepting welfare payments for their (technically) single mothers. It describes the problems that fundamentalism creates for a country founded on religious tolerance: a court threw out the conviction of one of the brothers, on the grounds that anyone who argued that he answered to the laws of God and not of man was incompetent to stand trial.

The two parts of Mr Krakauer's book co-exist rather uneasily. He never really explains how the church came to flourish, so much so that it is said by some to be the fastest growing faith in the western hemisphere. Nor does he explore, in any meaningful way, the contrast between the advance of the Church of Jesus Christ of Latter-Day Saints around the world as a church of the upwardly mobile and the respectable middle class, and the extremism of the church's American fundamentalists.

The future growth of the Mormons probably lies beyond American shores, fuelled by their energetic proselytising. As that truth dawns in Utah, the Mormon fathers may try to take a tougher line with their wild men. But, like other moderates who try to out-reason the blithe followers of the Almighty, they may find it hard to make themselves heard. Or, as Mr Krakauer puts it: “Common sense is no match for the voice of God.”

Under the Banner of Heaven: A Story of Violent Faith.
By Jon Krakauer.
Doubleday; 372 pages; $26.
To be published in Britain by Macmillan in September

Under the Banner of Heaven: A Story of Violent Faith
By Jon Krakauer



Doubleday; 372 pages; $26. To be published in Britain by Macmillan in September

Buy it at
Amazon.com
Amazon.co.uk

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Short stories

Funny girls

Jul 3rd 2003
From The Economist print edition

IF NOTHING else, A.M. Homes dispels once and for all the myth beloved of Britons that Americans have no sense of irony. On the opposite shore, Clare Boylan's unsentimental acerbity demonstrates that the new share-your-pain bathos of post-Diana Britain has failed to melt its Irish neighbours into goo.

In her first collection since her celebrated “The Safety of Objects” (1990), Ms Homes captures the stark absurdity and befuddlement of the American suburbs. Her suburbs, synonymous with nowhere-in-particular, are imbued with a jangled, dislocated sensibility and a relationship to nature that is not so much alienated as confused: “It's hard to know if it's been raining or if the sprinkler system has been acting up.” She likes the making-strange of everyday life, illustrating “how unfamiliar even the familiar can become”. No swimming pool can soothe the terror of supposed intimates who cannot sustain a conversation. No air filter can sift out the black cloud of impending medical disaster.

In “The Chinese Lesson,” an Anglo husband deploys the Global Positioning System to keep track of his wandering Chinese mother-in-law, an Alzheimer's patient with a computer chip implanted in her neck. (Odd, but not implausible—which goes for most of these stories.) The husband does not understand his wife, who hates being Chinese, as she cannot understand her husband, who likes her in part because she is Chinese. In fact, most of Ms Homes's characters appear unable to communicate with one another on even the most primitive pass-the-salt level, and the recognisable realism of their sorry attempts is sobering.

“Georgica” is as close as Ms Homes gets to romantic. Her wedding called off after her fiancé breaks her neck in a careless auto accident, the protagonist spends her summer evenings scrounging in the sand for the used condoms left behind by trysting young couples on the beach, so that she might inseminate herself with the warm contents back in her car.

Yet two of Ms Homes's most striking stories do not rely on the overtly bizarre. “Remedy” tells of a 35-year-old woman's consternation that her parents have invited a Buddhist loner named Ray to live with them and cook vitalising vegetarian meals. “His detachment is arrogant, infuriating. She wants to say, I've got your number; you think you're something special, like you were sent here from some other place, with little cymbals on your fingers—*ping*.” Successful in forcing him out, she destroys her parents' newfound happiness. In the best story, ravaging ovarian cancer fails to soften a wife's hostility to her husband or to quell his compulsion to flee. But when life goes so darkly awry, love and hatred can become indistinguishable. “We're really a bad match,” says he, “but we're such a good bad match that it seems impossible to let go.” For Ms Homes, a motto.

However tenderly rendered, the characters in Ms Boylan's stories fare little better in the communication department. In her poignant lead story, a harried mother having a torrid affair gets away for a dirty weekend. Sick of eating out alone and entranced with ordinary domestic contentment, her lover has installed a roast and carrots in his fridge in the hopes of a home-cooked meal. But his mistress arrives with finery expecting to paint the town red, and interprets his insistence on dining in as horror of being seen with her in public. The perfect misunderstanding is as heartbreaking as it is standard-issue in real-life romance.

Things You Should Know: A Collection of Stories
By A.M. Homes

HarperCollins; 224 pages; $23.95. Granta Books; £9.99

Buy it at
Amazon.com
Amazon.co.uk

The Collected Stories
By Clare Boylan

Counterpoint Press; 394 pages; $16.50.
Time Warner Books; £7.99

Buy it at
Amazon.com
Amazon.co.uk

Most of Ms Boylan's protagonists fall somewhere between eccentric and batty. A stranger in town is mistaken for “Edna”, who years before had fled to America. Faux Edna embraces her new identity, which apparently comes with cosy house and ready-made family; when it transpires that this family includes an ex-con wife-batterer, idiot child, and battleaxe mother-in-law, it's too late and Edna is trapped. Likewise when a childless woman kidnaps an infant from a grocery shop, she is lured into klepto-motherhood by the baby's beguiling pink outfit, only to discover the squalling bundle is a boy: “‘Hypocrite!' I said to him. ‘Going around with that nice little face!'” Like Edna, she is stuck with her wayward impulse; whenever she abandons the baby, people keep running to give him back.

Ms Boylan's style is witty: “The woman was so dazed with sedative and nicotine that she was a fire hazard as well as a terrible housekeeper.” She has a succinct descriptive knack: “She tried to compose an expression of intelligence on her face, which had lapsed into an aspect of carnal vegetation.” A lady's backside “resembled one of those family joints of meat that are tied about with string.” And though she draws comparison to compatriots, such as William Trevor, her stories are not in-your-face Irish; Ireland is merely where many of the tales happen to take place.

Sharp, slashing, and funny, these fine women writers challenge the nursery-school notion that girls are made of everything nice. Both have written offbeat, tough-minded collections that slither with snakes and snails.

Things You Should Know: A Collection of Stories.
By A.M. Homes.
HarperCollins; 224 pages; $23.95. Granta Books; £9.99

The Collected Stories.
By Clare Boylan.
Counterpoint Press; 394 pages; $16.50.
Time Warner Books; £7.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The National Theatre

The one hundred days of Mr Right

Jul 3rd 2003
From The Economist print edition

Is Nicholas Hytner doing a good job?

The guy's a doll

IT HAS been customary for the director of London's Royal National Theatre to suffer much grief in his first few months on the job. Sir Peter Hall, Sir Richard Eyre and Sir Trevor Nunn all had dark days before the clouds parted and the sun shone. The new man to occupy this most distinguished position in British theatre is 47-year-old Nicholas Hytner (plain Mr so far) and before he took the job he made it clear that he proposed to be a risk-taking director. On July 9th he will have been in the job for 100 days. How is he doing?

The permanent problem at the National Theatre has had little to do with art or artistry. Standards have never fallen, but it is greedy for income. Last year, it spent £37m ($61m), of which two-thirds has to come from the box office, catering and sponsorship; the other third is a subsidy from the Arts Council. When Mr Hytner was appointed, the audience was growing old and the seat prices were rising to West End levels. In an age in which accessibility is an artistic imperative, the audience was becoming an embarrassment.

One of Sir Trevor's solutions was to direct classical Broadway musicals like “Carousel” and “My Fair Lady” which transferred to the West End. The policy brought him much-needed revenue and critical opprobrium in roughly equal measures. In his quest for a new audience, Mr Hytner believed that to take no risks would, in the medium term, be more risky than sticking out his neck: “I thought we had to programme the repertory to attract a more diverse audience who demand an ever more adventurous product.” The only encouraging news in a difficult year for the London theatre was that, unlike the West End, the National Theatre is not vulnerable to a downturn in tourism. Only 7% of its audience is from overseas.

What Mr Hytner did was to slash seat prices for shows in the 1,100-seat Olivier theatre, which had become the most difficult to fill; 61% of the seats were priced at £10, the rest at £25 compared with a previous top price of £38. The plays are in an old fashioned repertory—a classic (“Henry V”), an American comedy (“His Girl Friday”) and a star vehicle (Kenneth Branagh in David Mamet's “Edmond”). He had some luck. Travelex, a foreign exchange company which had committed £1m over three years to support the £10 season, had withdrawn when the war in Iraq began. But the war ended, just in time. Travelex came back and all was right on the night.

An associated risk is that audiences will grow accustomed to cheap seats and revolt when the prices revert, but the initial reaction has been astonishing: “It can't last, but it's great that it has started this way,” Mr Hytner says. The season was budgeted to play to 70% capacity. The Olivier is 90-95% full and the £10 season is paying for itself. The box office reports that 31% of the audience are first-time buyers and nearly one in six has booked online. The critical reaction has been favourable too, though there have been some reservations about Mr Hytner's “Henry V” whose anti-war imagery struck some critics as shallow and opportunistic.

The odd lukewarm review has not dented his confidence. In repose, his face is gaunt, his receding hair is cut short and he looks like a figure in a German expressionist painting, until he smiles. Mr Hytner's reputation is for decisiveness (“takes no prisoners,” says one observer), but his theatrical taste is catholic and he is a power-sharer who has appointed a cabinet of advisers. These are actors, designers and

directors, acting unpaid, and they have already had input into the repertory. Sometimes the National Theatre has been like a place under siege. Not so this summer. Mr Hytner even likes Sir Denys Lasdun's monumental planked concrete building: “the 1970s are fashionable again,” he claims. Richard Eyre covered up the concrete wall in the director's office. Mr Hytner intends to expose it.

Foul-mouthed

The optimism is heavily influenced by the success of a zany musical, “Jerry Springer—The Opera”. This was Mr Hytner's second extravagant risk. “Jerry Springer” is inspired by the eponymous American confessional TV show. It is blasphemous, foul-mouthed and a complete sell-out. It plays in the smaller Lyttelton theatre and was scheduled for 95 performances at top prices largely on the basis of praise by word of mouth from last year's Edinburgh festival. A critical minority huffs and puffs about this not being something the National Theatre should encourage. The audience may provide the answer: “they are young, completely plugged into popular culture with a highly developed sense of irony,” Mr Hytner says, clearly pleased that his National is so switched on. One critic reports that he has not heard such wild applause since the theatre's “Guys and Dolls” 21 years ago.

Mr Hytner contemplated the failure of his risks, but he never imagined that they would be quite so successful. He has already been declared a hit. Michael Billington, a leading theatre reviewer who has been a persistent critic of earlier regimes, says: “He hasn't put a foot wrong so far.” Now that Mr Hytner has created an appetite for adventurous theatre at reasonable prices he has to satisfy it, but there are worse problems than that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Katharine Hepburn

Jul 3rd 2003
From The Economist print edition

Katharine Houghton Hepburn, actress, died on June 29th, aged 96

AFP

THE last time Katharine Hepburn had a part in a Hollywood film was in 1994 in “Love Affair”. Her minor role as an elderly aunt has largely been forgotten, except by Hepburn aficionados. To see her in a big role you have to go back to “On Golden Pond”, made in 1981. But that movie, although much admired, was not a typical Hepburn story: its theme was ageing and the imminence of death. Nor was “Guess Who's Coming to Dinner?”, made in 1967, about inter-racial marriage. You need to look at half a dozen romantic comedies she made in the 1930s and 1940s to get an idea of the style she brought to Hollywood movies. The words were not her own, of course. Hollywood at that time was blessed with clever writers. But no one was better than she at delivering their witty lines in her husky patrician voice.

She was an original, part of a pantheon whose members can be identified by single names, Garbo, Dietrich, Monroe, and among the men, Gable, Bogart and Chaplin, stars whose glitter has survived the generations. Kate Mulgrew, who did a solo show playing Katharine Hepburn, said that today's stars are ordinary “and they're terribly pleased to be ordinary. But in Hepburn's day stars were extraordinary, or nothing at all.”

Like Garbo, Miss Hepburn became aware that she had become something more than an actress, and found the transmogrification confusing. In her autobiography, “Me: Stories of My Life”, published in 1991, when she was 84, she gropes around trying to take a detached view of fame, and why it endures for some people. Typically, because her view of the world stretched beyond the film studio, her observations take in politicians she had known who saw that politics too could be part of the entertainment business.

> Let me say this. Churchill had personal charm. Roosevelt had personal charm... Personal charm is a great help. You can sit there and be an awful ass, but if you have personal charm you can really put it over on the general public. I think that Nixon had a terrible time with personal charm. Ronald Reagan on the other hand...smiles and he has a face that is ‘familiar' to the American public...I have become a familiar. I am very aware of that now. I am like the Statue of Liberty to a lot of people. When you've been around so long, people identify their whole lives with you...It's a curious sort of thing.

Miss Hepburn was continually curious about who she really was: how much of her personality was owed to the movies. Moviegoers knew who she was. She was Tracy Lord in “The Philadelphia Story”. She was “the tops, the Mona Lisa”, to pinch a phrase from Cole Porter. “The Philadelphia Story” started out as a play written by Phil Barry about a rich, amusing, high-spirited woman, based on his view of Miss Hepburn. The play was a success on Broadway and Miss Hepburn received especially good notices. She got Howard Hughes, with whom she was living at the time, to buy the movie rights of the play as a present for her. With these in her purse she went to see Louis B. Mayer, the most powerful producer in Hollywood. They agreed that some of her films had been duds. “People say I am poison at the box office,” said the always realistic Miss Hepburn. “The Philadelphia Story” was going to change that.

Smelling her out

Mayer, she said, “talked to me and smelled me out shrewdly” and asked her what she wanted for the film rights. Forget about money, Miss Hepburn said. What she wanted was Gable and Spencer Tracy to be her

leading men, but she settled for Cary Grant and James Stewart. The 1940 film turned out to be one of the great Hollywood comedies. She was box-office poison no longer. Other successes followed. She could do no wrong. Playing a hymn-singing spinster opposite a drunken Bogart in “The African Queen” seemed a crazy change of character. “I'm sure the script will stink and I certainly don't know why I am doing it all,” she said before setting out for the heart of darkness. But the film was a hit. The process of becoming “a familiar” had begun.

Miss Hepburn had not been born particularly rich, but she was brought up in a New England household where there was no obvious shortage of money. Her father was a surgeon. Her mother (every bit as good looking as Katharine, if photographs are a guide) enjoyed leisurely intellectual activities, supporting various movements for women's rights. Miss Hepburn swam throughout the year off Long Island, a regime she kept up into old age. “I wasn't a poor little thing,” she said. “I had about every advantage.”

She graduated from Bryn Mawr and got work in repertory companies, where she was spotted by a Hollywood scout. She was briefly married to a man called Smith, but had a number of lovers, the most enduring being Spencer Tracy. They lived together for 25 years until his death in 1967. They appeared together in nine films. Miss Hepburn had parts in 43 films (more if you include TV productions), received numerous Oscar nominations and was awarded four of the coveted statuettes, more than anyone else. But once you get into numbers, it sounds like you are talking about any competent actress who has got to the top. The point about Katharine Hepburn is that she was a good deal more than that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Jul 3rd 2003
From The Economist print edition

America's ISM index of manufacturing activity inched up in May, but by less than expected. It remains below the 50 level, which implies that output is still shrinking. Yet consumers keep on spending, with retail sales up by 6.1% in the 12 months to May. Inflation continues to wane: the 12-month rate of increase in the core personal consumer-expenditure deflator (excluding food and energy) fell to 1.2% in May.

There was cheerier news from **Japan.** The Bank of Japan's Tankan survey of business confidence in June produced stronger results than expected. Industrial production jumped by 2.5% in May, to 1.6% above its level of a year ago. In the same month, unemployment was unchanged at 5.4% of the labour force, but employment rose for the first time in over two years. The Nikkei 225 surged by 7.4% over the week, to its highest level for nine months.

Euro-area inflation rose to 2.0% in June, once again hitting the upper limit of the European Central Bank's inflation target of “less than but close to 2%”. The Reuters purchasing managers index for euro-area manufacturing fell again in June, to its lowest level since January 2002. German retail sales rose by a paltry 0.8% in the 12 months to May.

Britain's economy stalled in the first quarter of 2003, as GDP growth was revised down to only 0.1%. But output was still a respectable 2.1% up on a year earlier.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Jul 3rd 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.9	Q1	+ 2.8	+ 2.8	+ 3.5	nil	Q1	+ 4.0	Q1	6.0	May	6.2
Austria	+ 1.3	Q4	– 0.5	+ 0.5	+ 1.3	– 1.5	Dec	+ 0.9	Dec	4.4	Jun	4.3
Belgium	+ 1.3	Q1	+ 0.6	+ 0.8	+ 1.6	+ 1.6	Apr	nil	Apr	11.6	Jun†	10.4
Britain	+ 2.1	Q1	+ 0.3	+ 1.8	+ 2.5	– 1.8	Apr	+ 3.1	May	5.1	Apr††	5.2
Canada	+ 2.6	Q1	+ 2.4	+ 2.3	+ 3.0	– 1.0	Apr	+ 2.3	Mar	7.8	May	7.7
Denmark	+ 1.2	Q1	+ 1.4	+ 1.0	+ 2.0	– 0.2	Apr	– 1.6	Apr	6.0	May	5.1
France	+ 1.0	Q1	+ 1.0	+ 0.8	+ 1.9	– 0.5	Apr	– 2.0	May	9.3	May	8.9
Germany	+ 0.2	Q1	– 0.9	nil	+ 1.2	– 0.5	Apr	+ 0.8	May	10.7	May§	9.7
Italy	+ 0.8	Q1	– 0.4	+ 0.6	+ 1.6	+ 1.7	Apr	– 1.6	Mar‡	8.8	Apr	9.0
Japan	+ 2.6	Q1	+ 0.6	+ 0.8	+ 0.8	+ 1.6	May	– 2.7	Apr	5.4	May	5.4
Netherlands	nil	Q1	– 0.4	– 0.2	+ 1.3	– 0.8	Apr	– 0.6	Mar	5.3	May**	3.8
Spain	+ 2.1	Q1	+ 2.0	+ 1.9	+ 2.6	– 4.2	Apr	+ 2.7	Apr	11.3	May	11.3
Sweden	+ 2.2	Q1	+ 2.4	+ 1.4	+ 2.1	+ 3.4	Apr	+ 2.7	May	4.2	May†	3.4
Switzerland	nil	Q1	– 1.0	+ 0.1	+ 1.4	+ 0.9	Q1	– 5.9	Mar	3.6	May†‡	na
United States	+ 2.0	Q1	+ 1.4	+ 2.3	+ 3.4	– 0.8	May	+ 6.1	May	6.1	May	5.8
Euro area	+ 0.8	Q1	nil	+ 0.6	+ 1.7	+ 0.8	Apr	– 1.6	Mar	8.8	May	8.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 1.2	Q1	– 4.9	na	na	– 1.5	May	+ 3.7	Mar	11.4	May†	11.9
Greece	+ 4.3	Q1	na	na	na	– 0.1	Apr	na		na		na
Iceland	+ 3.3	Q1	na	na	na	– 0.3	2002	na		3.6	May†	2.5
Ireland	+ 6.4	Q4	na	na	na	+ 3.7	Apr	+ 3.2	Apr	4.6	May	4.3
Luxembourg	+ 1.1	2002	na	na	na	+ 4.5	Mar	+ 4.6	Jan	3.6	May	2.7
New Zealand	+ 3.6	Q1	+ 3.3	na	na	+ 5.9	Q4	+ 6.4	Q1	5.0	Q1	5.3
Norway	+ 0.6	Q1	+ 1.3	na	na	–13.6	Apr	+ 3.5	May	4.4	Q1	4.1
Portugal	– 1.2	Q1	+ 0.3	na	na	– 2.6	May	+ 0.3	May	6.4	Q1†	4.5

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 3.1% in May. §EU harmonised rate 9.4% in May. **Mar-May.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Jul 3rd 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.9	+ 2.5	+ 3.0	Q1	+ 0.5	+ 4.3	Q1	+ 4.1
Austria	+ 1.1	May	+ 1.9	+ 1.4	+ 1.1	+ 0.6	May	– 0.8	+ 2.1	May	+ 2.4
Belgium	+ 1.6	Jun	+ 0.9	+ 1.3	+ 1.1	– 0.4	May	– 0.2	+ 2.4	Q1	+ 3.1
Britain	+ 3.0	May	+ 1.1	+ 2.8	+ 2.4	+ 1.3	May	+ 0.1	+ 3.2	Apr	+ 3.3
Canada	+ 2.9	May	+ 1.0	+ 2.9	+ 2.0	– 1.7	May	– 2.2	+ 1.9	Apr	+ 2.8
Denmark	+ 2.2	May	+ 2.1	+ 2.3	+ 1.8	– 0.6	May	– 0.3	+ 3.9	Q1	+ 4.0
France	+ 1.8	May	+ 1.4	+ 1.8	+ 1.3	+ 0.7	May	– 1.2	+ 2.9	Q1	+ 4.0
Germany	+ 1.0	Jun	+ 1.0	+ 0.8	+ 0.5	– 0.2	May	– 1.3	+ 2.3	Apr	+ 2.4
Italy	+ 2.6	Jun	+ 2.2	+ 2.5	+ 1.8	+ 1.6	May	– 0.5	+ 1.7	May*	+ 2.3
Japan	– 0.2	May	– 0.9	– 0.4	– 0.5	– 1.0	May	– 2.2	+ 2.4	May	– 0.3
Netherlands	+ 2.3	May	+ 3.3	+ 2.4	+ 1.8	+ 2.5	May	– 1.9	+ 2.9	May	+ 3.6
Spain	+ 2.7	May	+ 3.6	+ 3.0	+ 2.5	+ 0.7	May	+ 0.5	+ 4.9	Q1	+ 4.0
Sweden	+ 1.9	May	+ 2.0	+ 2.1	+ 1.7	– 1.4	May	– 0.2	+ 2.3	Apr	+ 2.6
Switzerland	+ 0.5	Jun	+ 0.3	+ 0.7	+ 0.7	– 0.5	May	– 1.3	+ 1.8	2002	+ 2.5
United States	+ 2.1	May	+ 1.2	+ 2.2	+ 1.5	+ 2.5	May	– 2.9	+ 3.2	May	+ 2.6
Euro area	+ 2.0	Jun	+ 1.9	+ 1.8	+ 1.3	+ 1.3	May	– 0.8	+ 3.0	Q1	+ 3.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.7	May	+ 1.4	na	na	– 1.3	May	– 1.8	+ 4.1	Q1	+ 3.2
Greece	+ 3.8	May	+ 3.4	na	na	+ 2.4	May	+ 1.3	na		na
Iceland	+ 1.8	Jun	+ 4.8	na	na	+ 3.2	Jul	+ 7.1	+ 5.6	May	+ 7.5
Ireland	+ 3.7	May	+ 4.7	na	na	–10.0	May	– 0.5	+ 7.1	Q1	+ 6.9
Luxembourg	+ 1.9	May	+ 1.9	na	na	+ 1.8	Apr	– 2.5	+ 3.1	Mar	– 1.2
New Zealand	+ 2.5	Q1	+ 2.6	na	na	– 1.3	Q1	+ 2.8	+ 2.3	Q1	+ 2.1
Norway	+ 2.1	May	+ 0.4	na	na	– 4.5	May	–11.3	+ 5.3	Q1	+ 4.6
Portugal	+ 3.7	May	+ 3.3	na	na	+ 1.1	May	+ 0.6	+ 1.1	Apr	+ 0.1

*New series.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economic forecasts

Jul 3rd 2003
From The Economist print edition

The Economist poll of forecasters, July averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2003	2004	2003	2004	2003	2004	2003	2004
Australia	2.5/3.3	3.0/4.4	2.8 (3.0)	3.5 (3.6)	2.9 (2.7)	2.5	−5.1(−4.3)	−4.3 (−3.6)
Austria	nil/0.7	0.8/1.6	0.5 (0.9)	1.3 (1.6)	1.4 (1.5)	1.1 (1.3)	0.1(−0.1)	nil (−0.3)
Belgium	0.3/1.0	1.0/2.0	0.8 (1.0)	1.6 (2.0)	1.3 (1.4)	1.1 (1.3)	4.7 (4.9)	4.7 (5.0)
Britain	1.4/2.2	1.7/3.2	1.8	2.5	2.8	2.4 (2.4)	−1.4(−1.6)	−1.4 (−1.5)
Canada	1.7/2.8	2.4/3.8	2.3 (2.6)	3.0 (3.1)	2.9 (3.1)	2.0 (2.1)	1.8 (1.6)	1.5
Denmark	0.7/2.0	1.6/2.4	1.0 (1.4)	2.0 (2.2)	2.3 (2.4)	1.8 (1.9)	2.6 (2.4)	2.3 (2.4)
France	0.4/1.2	1.2/3.1	0.8 (1.0)	1.9 (2.2)	1.8	1.3 (1.4)	1.7	1.6 (1.5)
Germany	−0.3/0.3	0.5/1.7	nil (0.2)	1.2 (1.4)	0.8 (1.0)	0.5 (0.9)	2.1 (2.0)	1.9 (1.6)
Italy	0.3/1.0	0.8/2.5	0.6 (0.9)	1.6 (1.9)	2.5 (2.4)	1.8 (1.9)	−0.5(−0.4)	−0.5 (−0.3)
Japan	0.2/1.5	−0.3/2.1	0.8 (0.9)	0.8 (0.9)	−0.4 (−0.5)	−0.5	2.2 (2.5)	2.4 (2.6)
Netherlands	−0.8/0.4	0.5/2.8	−0.2 (0.2)	1.3 (1.7)	2.4 (2.5)	1.8 (2.1)	2.5 (2.9)	2.7 (3.1)
Spain	1.6/2.7	2.1/3.5	1.9 (2.0)	2.6 (2.7)	3.0	2.5 (2.6)	−2.3(−2.2)	−2.3 (−2.2)
Sweden	0.9/2.0	1.7/2.9	1.4	2.1 (2.3)	2.1 (2.4)	1.7 (1.8)	3.5 (3.6)	3.3 (3.6)
Switzerland	−0.5/0.9	0.5/2.4	0.1 (0.7)	1.4 (1.7)	0.7	0.7 (0.9)	11.6(11.7)	11.3 (11.7)
United States	1.9/2.6	2.2/4.4	2.3 (2.2)	3.4 (3.3)	2.2 (2.3)	1.5 (1.7)	−5.3	−5.5 (−5.4)
Euro area	0.3/0.9	1.1/2.6	0.6 (0.8)	1.7 (2.0)	1.8 (1.9)	1.3 (1.5)	0.7	0.6

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month *The Economist* calculates the average of a group of forecasters' predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. For the second month running, the panel has yanked down its forecast for euro-area growth. It now expects GDP in the euro area to grow by only 0.6% in 2003 and by 1.7% in 2004, down from 0.8% and 2.0% in June. By contrast, the panel has become more optimistic about the outlook for the United States, which is predicted to grow by 2.3% in 2003 and by 3.4% in 2004. After outpacing the euro area this year, Japan will revert to bringing up the rear in 2004, with forecast growth of only 0.8%.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Jul 3rd 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 2nd 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 4.7	+11.6	May	4.72	5.00	4.46	5.07	6.02	5.84
Britain	+ 7.9	+ 8.3	May	3.63	4.09	3.26	4.25	5.01	5.83
Canada	+10.3	+ 7.1	May	3.09	2.75	3.01	4.54	5.39	6.22
Denmark	+ 9.7	+12.2	May	2.25	3.68	2.16	4.01	5.13	5.30
Japan	+ 4.8	+ 1.6	May	0.01	0.03	0.08	0.88	1.31	0.93
Sweden	+ 4.0	+ 7.1	May	2.71	4.29	2.91	4.26	5.37	3.41
Switzerland	+27.6	+10.6	May	0.28	1.20	0.30	2.41	3.08	3.14
United States	+ 6.4	+ 6.6	May	1.03	1.74	1.29	3.53	4.74	5.48
Euro area†	+11.4	+ 8.5	May	2.15	3.43	2.13	3.82	4.87	3.84

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.58%, Japan No.250 0.90%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Jul 3rd 2003
From The Economist print edition

1995=100

	Jun 24th	Jul 1st*	% change on one month	% change on one year
Dollar index				
All items	76.6	76.0	– 1.2	+ 4.9
Food	76.7	76.3	– 1.7	+ 3.8
Industrials				
All	76.6	75.7	– 0.5	+ 6.3
Nfa†	81.5	80.1	+ 3.8	+10.5
Metals	72.5	71.9	– 4.3	+ 2.6
Sterling index				
All items	72.6	72.2	– 3.1	– 3.4
Euro index				
All items	87.5	86.2	– 0.2	–10.8
Yen index				
All items	96.1	96.5	– 0.9	+ 4.0
Gold				
$ per oz	347.55	351.80	– 3.6	+11.9
West Texas Intermediate				
$ per barrel	28.69	30.32	– 1.2	+13.0

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Jul 3rd 2003
From The Economist print edition

Market indices

	Jul 2nd	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,003.4	3,077.0	2,673.3	– 0.9	–12.7	+ 0.9	+21.8
Austria (ATX)	1,331.9	1,331.9	1,120.2	+ 2.4	–23.3	+15.8	+27.1
Belgium (Bel 20)	1,931.4	2,074.1	1,426.6	– 0.5	–47.5	– 4.6	+ 4.7
Britain (FTSE 100)	4,006.9	4,207.0	3,287.0	– 1.5	–42.2	+ 1.7	+ 5.1
Canada (Toronto Composite)	6,990.3	7,121.0	6,228.6	+ 0.3	–38.6	+ 5.7	+24.6
Denmark (KBX)	184.8	188.8	145.0	– 0.3	–38.8	+11.1	+21.9
France (SBF 250)	2,077.0	2,154.5	1,630.1	– 0.6	–52.7	+ 1.2	+11.0
(CAC 40)	3,079.1	3,213.9	2,403.0	– 1.0	–55.5	+ 0.5	+10.3
Germany (DAX)	3,241.0	3,304.2	2,203.0	+ 1.3	–59.8	+12.0	+23.0
Italy (BCI)	1,143.0	1,195.9	959.4	– 2.4	–47.6	+ 4.7	+14.9
Japan (Nikkei 225)	9,592.2	9,592.2	7,607.9	+ 7.4	–75.4	+11.8	+11.6
(Topix)	945.2	945.2	770.6	+ 6.9	–67.2	+12.1	+11.9
Netherlands (AEX)	294.2	337.3	218.4	– 0.1	–58.1	– 8.8	+ 0.0
Spain (Madrid SE)	717.4	737.3	576.8	– 1.0	–37.4	+13.2	+24.2
Sweden (Affarsvarlden Gen)	155.4	158.6	127.8	+ 0.9	–61.2	+ 7.1	+16.9
Switzerland (Swiss Market)	4,789.8	4,992.5	3,675.4	– 0.9	–43.1	+ 3.4	+ 6.1
United States (DJIA)	9,142.8	9,323.0	7,524.1	+ 1.5	–22.0	+ 9.6	+ 9.6
(S&P 500)	993.8	1,011.7	800.7	+ 1.9	–34.9	+13.0	+13.0
(NASDAQ Comp)	1,678.8	1,678.8	1,271.5	+ 4.7	–66.7	+25.7	+25.7
Europe (FTSE Eurotop 300)*	848.4	890.8	682.7	– 1.3	–50.2	– 1.0	+ 8.6
Euro area (FTSE Ebloc 100)*	729.1	758.6	565.7	– 1.0	–53.0	+ 1.5	+11.4
World (MSCI)†	886.4	907.3	710.8	+ 1.1	–38.8	na	+11.9
World bond market (Citigroup)‡	564.2	583.9	518.6	– 1.4	– 3.4	na	+ 7.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Jul 3rd 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 Jul 2nd	year ago	Currency units per $ Jul 2nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 9.0	Apr	− 20.8	Q1	− 5.1	− 4.3	84.9	74.5	1.47	1.79	2.45	1.69	1.24	0.2
Austria	+ 0.7	Mar	+ 1.7	Apr	+ 0.1	nil	102.3§	100.1	0.87	1.02	1.45	–	0.73	-1.3
Belgium	+ 17.3	Apr	+ 11.1	Feb	+ 4.7	+ 4.7	102.2§	98.9	0.87	1.02	1.45	–	0.73	nil
Britain	− 56.8	Apr	− 5.8	Q1	− 1.4	− 1.4	100.9	104.3	0.60	0.66	–	0.69	0.51	-1.9
Canada	+ 36.2	Apr	+ 13.9	Q1	+ 1.8	+ 1.5	87.2	77.5	1.34	1.53	2.23	1.54	1.13	1.1
Denmark	+ 9.2	Apr	+ 5.7	Apr	+ 2.6	+ 2.3	106.5	103.0	6.45	7.58	10.7	7.43	5.43	1.6
France	+ 7.4	Apr	+ 25.3	Apr	+ 1.7	+ 1.6	105.5§	101.5	0.87	1.02	1.45	–	0.73	-3.6
Germany	+124.7	Apr	+ 48.6	Apr	+ 2.1	+ 1.9	102.8§	98.4	0.87	1.02	1.45	–	0.73	-3.7
Italy	+ 5.4	Apr	− 11.5	Mar	− 0.5	− 0.5	75.2§	72.4	0.87	1.02	1.45	–	0.73	-2.4
Japan	+ 95.4	Apr	+111.7	Apr	+ 2.2	+ 2.4	127.3	135.2	119	120	198	137	–	-7.7
Netherlands	+ 29.5	Apr	+ 2.9	Q1	+ 2.5	+ 2.7	101.6§	97.8	0.87	1.02	1.45	–	0.73	-1.6
Spain	− 44.4	Apr	− 19.8	Mar	− 2.3	− 2.3	76.6§	74.2	0.87	1.02	1.45	–	0.73	-0.4
Sweden	+ 15.7	May	+ 11.5	Q1	+ 3.5	+ 3.3	80.5	77.8	7.98	9.30	13.3	9.19	6.71	0.7
Switzerland	+ 5.5	May	+ 32.0	Q4	+11.6	+11.3	111.4	114.5	1.35	1.49	2.24	1.55	1.13	na
United States	−519.7	Apr	−510.2	Q1	− 5.3	− 5.5	102.4	113.2	–	–	1.66	1.15	0.84	-4.6
Euro area	+ 86.8	Apr	+ 44.1	Apr	+ 0.7	+ 0.6	90.2	81.8	0.87	1.02	1.45	–	0.73	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.4	Apr	+ 9.3	Apr	na	na	81.1§	77.9	0.86	1.02	1.43	–	0.72	3.1
Greece	− 23.0	Apr	− 11.0	Apr	na	na	59.1§	57.5	0.86	1.02	1.43	–	0.72	-1.0
Iceland	+ 0.1	May	nil	Q1	na	na	97.7**	86.9	76.5	86.4	127	88.1	64.4	nil
Ireland	+ 36.2	Mar	− 0.2	Q4	na	na	93.4§	87.0	0.86	1.02	1.43	–	0.72	-0.8
Luxembourg	− 3.1	Feb	+ 1.7	Q4	na	na	102.2§	98.9	0.86	1.02	1.43	–	0.72	0.2
New Zealand	− 0.9	Apr	− 1.4	Q1	na	na	100.0	88.8	1.68	2.05	2.80	1.93	1.41	0.8
Norway	+ 27.8	May	+ 25.7	Apr	na	na	97.5	105.8	7.16	7.48	11.9	8.25	6.02	11.3
Portugal	− 12.5	Mar	− 8.1	Mar	na	na	92.5**	89.9	0.86	1.02	1.43	–	0.72	-3.2

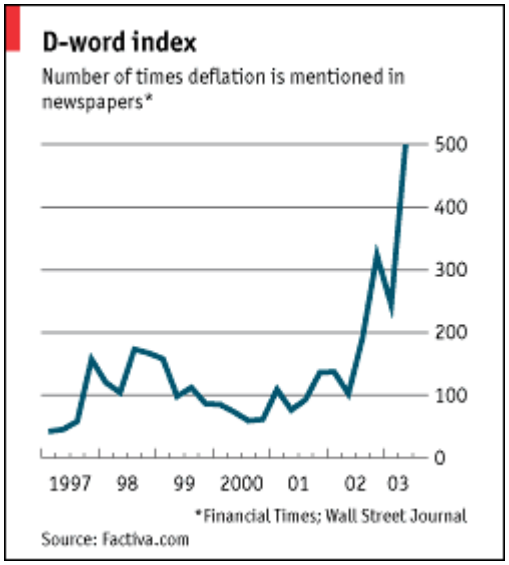
*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, February average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

D-word index

Jul 3rd 2003
From The Economist print edition

Deflation is rampant. *The Economist's* D-word index (which counts the stories in the *Financial Times* and the *Wall Street Journal* that include the word deflation) surged in the second quarter to its highest level since the 1930s.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Jul 3rd 2003
From The Economist print edition

India's economy grew by 4.9% in the year to the first quarter. That was way below earlier forecasts, thanks mainly to the country's worst drought in over a decade.

Turkey's economy is rebounding: GDP grew by 8.1% in the year to the first quarter.

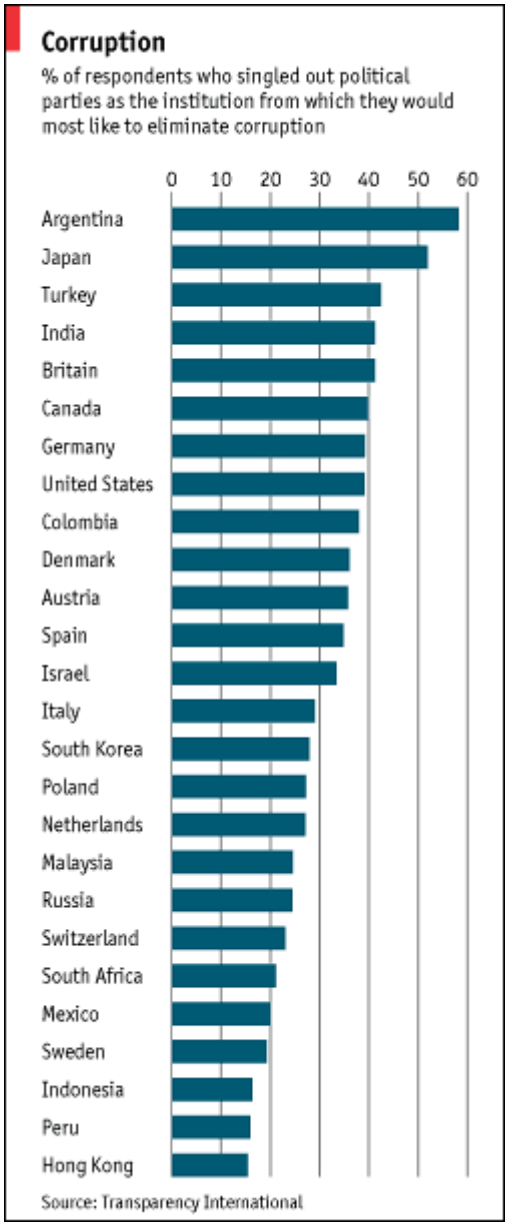
Singapore's industrial output fell by 9.5% in the year to May, thanks in part to SARS.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Corruption

Jul 3rd 2003
From The Economist print edition

Political parties top citizens' list of organisations they want to see cleansed of corruption, according to a survey by Transparency International, a Berlin-based anti-corruption pressure group. In Argentina, 58% of respondents singled out political parties as a prime source of corruption. Japan, not usually at the top of corruption lists, reported the next highest figure, at 52%. In both Sweden and Mexico, however, only around a fifth of respondents agreed that politicians' shenanigans were their most important corruption complaint.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Jul 3rd 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+13.7	May	+ 0.7	May	+22.2	May	+35.4	2002	320.9	Mar
Hong Kong	+ 4.5	Q1	– 8.8	Q1	– 2.5	May	– 7.6	May	+18.4	Q1	116.1	May
India	+ 4.9	Q1	+ 4.9	Apr	+ 5.1	Apr	–10.1	Apr	+ 4.8	Q4	77.9	May
Indonesia	+ 3.4	Q1	+18.4	Mar	+ 6.6	Jun	+25.3	May	+ 7.5	Q4	33.0	May
Malaysia	+ 4.0	Q1	+11.8	Apr	+ 1.0	May	+16.3	May	+ 8.5	Q1	35.4	May
Philippines	+ 4.5	Q1	+ 2.0	Apr	+ 2.7	May	– 0.1	Apr	+ 2.9	Mar	12.7	May
Singapore	+ 1.6	Q1	– 9.5	May	– 0.1	May	+12.3	May	+21.3	Q1	85.8	May
South Korea	+ 3.7	Q1	– 1.9	May	+ 3.0	Jun	+ 8.8	Jun	+ 2.7	May	128.3	May
Taiwan	+ 3.2	Q1	– 2.8	May	+ 0.3	May	+16.7	May	+25.9	Q1	175.2	May
Thailand	+ 6.7	Q1	+12.8	May	+ 1.7	Jun	+ 4.3	May	+ 8.3	May	38.0	May
Argentina	+ 5.4	Q1	+12.2	May	+14.3	May	+17.0	May	+10.2	Q1	11.4	May
Brazil	+ 2.0	Q1	– 4.2	Apr	+17.2	May	+20.9	Jun	– 0.6	May	41.5	Apr
Chile	+ 3.5	Q1	+ 4.0	May	+ 3.5	May	+ 2.4	May	– 0.6	Q1	15.9	May
Colombia	+ 3.8	Q1	+15.3	Mar	+ 7.7	May	– 0.4	Feb	– 1.6	Q4	10.6	May
Mexico	+ 2.3	Q1	– 4.8	Apr	+ 4.7	May	– 6.6	May	–12.7	Q1	53.6	May
Peru	+ 2.5	Apr	– 0.5	Apr	+ 2.4	May	+ 0.4	Apr	– 1.1	Q1	9.7	May
Venezuela	–29.0	Q1	–14.7	Mar	+35.0	May	+15.0	Q1	+ 9.5	Q1	9.9	Mar
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.7	Apr	– 7.4	Jan	+ 1.0	Q1	13.1	Feb
Israel	+ 0.3	Q1	– 2.4	Apr	+ 1.6	May	– 5.6	May	– 0.5	Q1	23.7	May
South Africa	+ 2.5	Q1	– 4.9	Apr	+ 7.8	May	+ 3.2	May	– 0.2	Q1	6.0	May
Turkey	+ 8.1	Q1	+ 4.2	Apr	+30.7	May	–16.9	Apr	– 3.3	Apr	28.6	May
Czech Republic	+ 2.2	Q1	+ 5.6	Apr	nil	May	– 2.3	May	– 4.4	Q1	26.1	May
Hungary	+ 2.7	Q1	+ 6.8	Apr	+ 3.6	May	– 2.8	Apr‡	– 3.6	Apr	10.9	May
Poland	+ 2.2	Q1	+11.7	May	+ 0.4	May	–10.2	May	– 5.6	May	32.3	May
Russia	+ 5.2	Q4	+ 8.5	May	+13.6	May	+52.1	Apr	+38.3	Q1	61.1	May
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*												
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.6	May	– 1.2	May	+ 2.6	2002†	9.7	Apr
Saudi Arabia	+ 0.7	2002§	na		– 1.4	Mar	+38.6	2002§	+11.7	2002	23.1	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series. §Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Jul 3rd 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 2nd		Dec 31st 2002	
	Jul 2nd	year ago	Jul 2nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.8	na	1,570.2	–0.2	+ 10.6	+ 10.6
Hong Kong	7.80	7.80	13.0	1.12	9,602.6	–0.3	+ 3.0	+ 3.0
India	46.3	48.8	77.1	4.94	3,601.4	+2.4	+ 6.6	+ 10.4
Indonesia	8,220	8,965	13,682	10.03	506.1	+1.2	+ 19.1	+ 29.7
Malaysia	3.80	3.80	6.33	3.10	703.3	+3.1	+ 8.8	+ 8.8
Philippines	53.3	50.7	88.8	9.00	1,228.0	–0.3	+ 20.6	+ 20.7
Singapore	1.75	1.77	2.92	0.56	1,477.2	+1.0	+ 10.2	+ 9.0
South Korea	1,187	1,198	1,976	4.30	685.8	+1.7	+ 9.3	+ 9.2
Taiwan	34.5	33.5	57.4	1.10	5,095.2	+3.3	+ 14.4	+ 15.4
Thailand	41.9	41.6	69.7	1.44	477.7	+5.3	+ 34.0	+ 37.9
Argentina	2.80	3.56	4.66	11.31	749.0	–5.5	+ 42.7	+ 71.3
Brazil	2.83	2.87	4.71	25.76	13,310.5	+2.2	+ 18.1	+ 47.9
Chile	696	698	1,158	2.76	6,049.6	+1.5	+ 20.5	+ 24.8
Colombia	2,812	2,428	4,680	7.78	2,082.8	–0.2	+ 29.5	+ 32.0
Mexico	10.48	9.97	17.4	4.38	7,164.0	+1.2	+ 16.9	+ 16.7
Peru	3.47	3.52	5.78	3.71	1,838.0	+0.4	+ 32.0	+ 33.8
Venezuela	1,598	1,281	2,660	16.08	13,801.6	–2.9	+ 72.2	+ 49.4
Egypt	6.07	4.64	10.10	10.27	8,468.9	+1.4	+ 57.7	+ 20.3
Israel	4.30	4.77	7.15	4.99	458.9	+3.7	+ 38.0	+ 52.5
South Africa	7.4	10.2	12.4	11.60	8,396.9	–0.7	– 9.5	+ 4.5
Turkey	1,402,000	1,620,000	2,333,629	37.00	10,690.9	–0.5	+ 3.1	+ 22.1
Czech Republic	27.5	30.0	45.7	2.24	538.8	+1.2	+ 17.0	+ 28.0
Hungary	229	250	381	9.58	7,877.2	nil	+ 1.0	– 0.8
Poland	3.85	4.09	6.41	5.26	15,921.8	–0.1	+ 10.8	+ 10.4
Russia	30.3	31.5	50.4	16.00	518.1‡	+3.2	+ 36.7	+ 44.3
EMF (MSCI)*	1.00	1.00	1.66	na	341.3	+2.6	na	+ 16.9
EMBI+†	1.00	1.00	1.66	na	275.0	–0.9	na	+ 20.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.